S. HRG. 98-185

ENTERPRISE ZONES—1983

HEARING

BEFORE THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

NINETY-EIGHTH CONGRESS

FIRST SESSION

ON

S. 98, S. 634, and S. 863

APRIL 22, 1983

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ENTERPRISE ZONES—1983

FRIDAY, APRIL 22, 1983

U.S. Senate,
Committee on Finance,
Washington, D.C.

The committee met, pursuant to notice, at 9:35 a.m. in room SD-215, the Dirksen Senate Office Building, the Honorable Robert J. Dole (chairman of the committee) presiding.

Present: Senators Dole, Chafee, Heinz, Long, and Bradley.

[The press release announcing the hearing, the opening statement of Senator Dole, and the descriptions of S. 98, S. 634, and S. 863 follow:]

[Press Release]

Finance Committee Sets Hearings on Enterprise Zones

Senator Robert J. Dole (R., Kans.), Chairman of the Senate Committee on Finance, announced today that the Committee will hold hearings on Friday, April 22, 1983, on legislation proposed by the administration, S. 863, to establish enterprise zones. S. 863 was introduced by Senators Boschwitz, Chafee, Dole, Danforth, Roth, Heinz, Grassley, Durenberger, Matsunaga, Bradley, and others. The hearing will also focus on S. 98, introduced by Senator Boschwitz, and on S. 634, the Community Assistance and Revitalization Act of 1983, introduced by Senator Hart.

The hearing will begin at 9:30 a.m. on April 22, 1983, in room SD-215 (formerly 2221) of the Dirksen Senate Office Building.

Senator Dole said that the committee was particularly interested in receiving the views of the public on the criteria to be used in designating enterprise zones, on the effectiveness of tax incentives in stimulating new economc activity in zones, and on the effectiveness of reducing Federal, State or local regulations as a means of encouraging greater business activity in enterprise zones.

"For the second year in a row, the President has unveiled a specific proposal for enterprise zones. Thanks to the leadership of Senator Chafee, who initiated hearings in the 97th Congress, the Senate made progress on this legislation last year. Unfortunately, no final action was taken. It is time to move forward in Congress and develop a consensus on this new approach to the problem of economic redevelopment. I hope that these hearings will form the basis for early legislative action on the enterprise zone concept," Dole said.

As proposed by the Reagan adminstration, enterprise zones would be areas designated by the Federal Government as economically distressed. Localities designated as enterprise zones would be eligible for certain Federal tax and regulatory incentives to encourage the creation of new jobs and business enterprises. In order to qualify for designation as a zone, the local community would have to demonstrate a strong commitment to the revitalization effort by proposing specific actions it would take to stimulate economic growth within the zone.

Statement of Senator Dole

ENTERPRISE ZONES

I know we all appreciate having this early opportunity to review President Reagan's enterprise zone proposal as resubmitted to the 98th Congress. This is the third time that the Finance Committee has had the opportunity to consider enterprise zones in hearings: in 1981 hearings were held on legislation introduced by Senators Chafee and Boschwitz, and last spring another hearing was held on the administration's initial proposal. Both hearings were conducted by our distinguished colleague from Rhode Island, Senator Chafee, in the Subcommittee on Savings, Pensions, and Investment Policy. It was largely due to the leadership he and Senator Boschwitz have shown in this area that our committee reported out legislation last fall to implement the President's program for economic redevelopment. Unfortunately, that legislation did not receive final action in the 97th Congress: what is more, to date the Finance Committee remains the only committee of the Congress that has any legislative experience with the enterprise zone concept. That is the first thing that will have to change if the President's proposal is ever to be implemented.

SHAPING A PROPOSAL

In reporting its version of enterprise zones last fall this committee, in cooperation with the administration, undertook a number of steps towards simplification and cost-efficiency, and it is good to see that some of these have been incorporated in S. 863 this year. I agreed to cosponsor S. 863 this year because it is important that we demonstrate a commitment to deal with the problems of our nation's economically distressed areas, and because it is appropriate to do that with a program that, while admittedly experimental in nature, is calculated to take advantage of the latent resources that exist in every community in this nation, however difficult their economic circumstances. These resources are the individual initiative, drive, and community spirit of our citizens, and we owe it to ourselves to see how we can best harness those considerable energies through the private sector before undertaking more of the costly government subsidy programs that have had less than spectacular results in the past.

This legislation has already been reshaped several times, and certain parameters seem to have been set. It seems generally agreed that, at least at the outset, enterprise zones will be a limited program, to give us experience with reducing tax and regulatory burdens on a discrete basis to improve the prospects for economic development. At the same time, it seems clear that such action is not sufficient in itself unless there is a significant commitment from governments with jurisdiction over the zones, and from the people and community organizations, to make an all-out effort to succeed. Federal incentives are not intended to be the driving force behind development, but are additional tools to be made available to communities that demonstrate the initiative to tackle their own problems head-on.

THE PROPER PERSPECTIVE

If we maintain a realistic view of the enterprise zone concept and what it is designed to achieve, we are more likely to succeed: both in the legislative process and in making real progress toward redeveloping distressed areas. For example, there are no guarantees that any particular formulation of the enterprise zone concept will generate new economic activity exclusivity, rather than induce some shifting of economic activity into the enterprise zone. But we are not looking for a perfect solution, but a set of criteria for choosing eligible areas and a package of incentives that is most likely to generate new development without doing so at the expense of nearby areas. I think that is a sensible goal that we can agree on, and that we can achieve if we put our minds to it.

That does not mean there are no significant questions left to be answered: there are, and we ought to be willing to give this legislation a fresh look to see that it meets or goals, have a clear explanation of how it will work, and prepare to make changes where the answers are not satisfactory. We do need some guidance as to how HUD will exercise its discretion in designating zones—we do not want to bind the administration, but we do want reassurance that we share an understanding of where this legislation should lead. I am particularly pleased that Secretary Pierce is here this morning to help give us that guideance.

In addition, the interaction between the Federal tax incentives offered under the administration bill and the State and local commitments to be made in setting up an enterprise zone needs to be properly understood: How will Federal tax relief affect the types of development the zone attracts, and to what extent will it influence the nature of the incentives offered by the State and locality. Coordination between Federal and State enterprise zone legislation also is a matter that is becoming more important as States move forward with their own packages of incentives for targeting economic development efforts.

The important thing is that all these questions can be answered if we are prepared to buckle down and do the job. The most important function this hearing can have is to send precisely that signal: that the President and the Congress are serious about this legislation, and we intend to put forth the best possible proposal. It would be particularly helpful if that message were clearly conveyed to the other side of the Capitol, so that our colleagues in the House can join us in this effort. And it ought to be a cooperative effort, since we are acting in good faith to achieve goals we all share, on both sides of the aisle.

With those comments I would like to welcome our witnesses this morning. I know they will establish a strong record that will help shape a consensus proposal that can be enacted by this Congress.

Attached to my statement is a summary of the provisions of S. 863 as proposed by President Reagan.

DESCRIPTION OF BILLS
(S. 863, S. 98, and S. 634)
RELATING TO
ENTERPRISE ZONES

SCHEDULED FOR A HEARING

BEFORE THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

ON APRIL 22, 1983

PREPARED BY THE STAFF OF THE

JOINT COMMITTEE ON TAXATION

INTRODUCTION

The Senate Finance Committee has scheduled a public hearing on April 22, 1983, on several bills dealing with enterprise zones. These include the Administration's proposal to provide tax and other incentives in designated zones in economically distressed areas; this proposal is contained in S. 863 (introduced by Senators Boschwitz, Chafee, Danforth, Roth, Heinz, Grassley, Durenberger, Matsunaga, Bradley, Dole and others). The other bills to be considered at the hearing are S. 98 (introduced by Senators Boschwitz, Grassley and others) and S. 634 (introduced by Senator Hart). S. 98 and S. 863 are similar to the enterprise zone provisions of a bill (H.R. 7094) reported by the Finance Committee on October 18, 1982 (S. Rep. No. 97-662). H.R. 7094 was not acted on by the Senate in the 97th Congress.

This pamphlet, prepared in connection with the hearing, contains descriptions of the various provisions of the bills. The first part of the pamphlet is a summary of present law and the bills. This is followed with descriptions of the provisions of the bills and the corresponding portions of present law. An Appendix provides a summary description of area eligibility criteria for Urban Development Action Grants (UDAG).

I. SUMMARY

Present Law

Tax incentive provisions

Targeted area

The Internal Revenue Code generally does not contain rules for targeting areas for special tax treatment. However, Code section 103A, relating to mortgage subsidy bonds, defines targeted areas for the purpose of promoting housing development within these areas. Within such areas, defined on the basis of the income of area residents or the general economic condition of the area, rules for the issuance of mortgage subsidy bonds are less restrictive than the generally applicable rules. In addition, certain domestic corporations deriving income from Puerto Rico and possessions of the United States are eligible for a tax credit that eliminates U.S. tax on that income.

Tax credits for employers

Present law contains no provisions under which an employer's tax liability varies according to the location of its employees. Prior law contained the new jobs credit, which provided a tax credit, for 1977 and 1978, based on the increase in the employer's payroll over that of the prior year. Under present law, the targeted jobs tax credit provides a tax credit for a portion of wage payments made to certain groups of employees. These groups generally are defined according to the individual's physical condition, participation in a specified education or rehabilitation program, and economic status.

Tax credit for employees

Under present law the tax liability of an employee working in the United States generally does not vary according to the location of his employment. The earned income credit provides a refundable tax credit for a portion of earned income (wages, salaries, and earnings from self-employment) to families with children and with income less than $10,000.

Investment tax credit

Under present law, a 10-percent regular investment tax credit applies to eligible tangible personal property used in a trade or business or for the production of income. In addition, the credit applies to expenditures to rehabilitate industrial and commercial buildings which are at least 30 years old. The basis of the property is reduced by one-half (or, in the case of certain rehabilitation credits, by the full amount) of the investment credits allowed for the property. (See also energy tax credits, below.)

Capital gains taxation

Gain from the sale or exchange of a capital asset is taxable at reduced rates (a maximum 20 percent rate for noncorporate taxpayers and 28 percent for corporations). Capital assets generally include any property held by the taxpayer with the exception of property used, or held for sale, in the taxpayer's trade or business. This reduction in tax is treated as a preference item for purposes of the noncorporate and corporate minimum taxes.

Industrial development bonds

Although interest on State or local bonds used to finance trade or business activity (industrial development bonds) is generally taxable, various exceptions are provided, including, until December 31, 1986, bonds issued in certain "small issues." Property financed with IDBs generally is allowed cost recovery deductions at a slower rate than those otherwise allowed.

Treatment of losses on certain small business stock

Under present law, if an individual incurs a loss on certain small business stock, the loss is treated as an ordinary, rather than a capital, loss.

General stock ownership (GSOC) provisions

A GSOC is a domestic corporation that is chartered by an act of a State legislature or as a result of a statewide referendum. Shares in the corporation may be owned only by residents of the State. A GSOC is empowered to invest in properties, and 90 percent of its taxable income for any taxable year must be distributed to shareholders.

Employee ownership tax credit provisions

An employee stock ownership plan (ESOP) is a tax-qualified plan under which employer stock is held for the benefit of employees. The stock, which is held by a tax-exempt trust under the plan, may be acquired through direct employer contributions or with the proceeds of a loan to the trust. An employer who maintains an ESOP is permitted a deduction (within limits) for contributions to the plan. In addition, if the employer contributes additional cash or securities to an ESOP which qualifies as a tax credit ESOP, the employer may be entitled to an additional tax credit. No person other than the employer is allowed any deduction for ESOP contributions, and no other credit or deduction based on employee ownership is permitted to the employer.

Energy tax credit provisions

A tax credit of 15 percent is allowable for insulation and qualified energy conservation expenditures which include various weatherproofing items, devices to improve efficiency of heating units, and energy conserving thermostats and meters.

A 40-percent tax credit is available for renewable energy sources which use solar, wind, geothermal or other renewable energy sources.

Both credits are available for expenditures through 1985 with respect to a dwelling unit in the United States that is the taxpayer's principal residence.

Energy investment tax credits, between 10 and 15 percent, are allowable for qualified expenditures through 1985, for solar, wind, ocean and geothermal property, certain hydroelectric generating property and intercity buses, and biomass property.

Nontax provisions

Regulatory flexibility

Present law provides that certain regulatory procedures are to be followed in order to ease the regulatory burden on small businesses, small nonprofit organizations, or small governmental jurisdictions.

Foreign trade zones

A foreign trade zone may be established within any port of entry. For imported goods shipped into a zone, duties are not levied until and unless goods are sent into other United States territory.

Small business loans

Direct loans may be made to small businesses from funds appropriated for these purposes. The loans may be direct or guaranteed, and made by agencies authorized to do so or by banks and other financial institutions. The loans may be made for the acquisition of land, structures and productive equipment.

Summary of S. 863

Under S. 863, businesses and employers located in an enterprise zone would be entitled to various tax incentives and special regulatory status, as summarized below.

Title I. Designation of enterprise zones

Enterprise zones would be designated by the Secretary of Housing and Urban Development after competitive review of State and local government nominations. Each nominated zone would have to satisfy various requirements concerning economic, demographic, and physical characteristics. The State and local governments seeking designation of a nominated area as an enterprise zone would be required to commit themselves to specific actions to enhance the development of the area. The Secretary would be required to designate up to 75 areas as enterprise zones during the three-year period after enactment of the bill. A designation would remain in effect for 24 years, unless a shorter period were requested by the nominating governments or the Secretary revoked the designation.

Title II. Tax incentive provisions

Tax credit for enterprise employers

The bill would provide employers with a two-part nonrefundable tax credit. The first would be a credit equal to 10 percent of qualified wages in excess of the amount of qualified wages paid in the 12-month period before the area was designated as an enterprise zone, if earlier, or the date on which the enterprise zone was designated under State law, enacted after January 1, 1981. Qualified wages would be wages paid (subject to a limitation) to qualified employees, i.e., individuals 90 percent or more of whose services directly related to the zone business and 50 percent of whose services were performed in the zone. The second credit would be available for a portion of wages paid to certain disadvantaged individuals who were qualified employees.

Tax credit for zone employees

Qualified employees would be allowed a nonrefundable tax credit equal to 5 percent of earnings (up to 1½ times the FUTA wage base).

Investment tax credit for zone property

An additional investment tax credit of 3 or 5 percent, depending on the type of property, would be allowed for personal property used in a trade or business in an enterprise zone. A 10-percent credit would be allowed for eligible real property. A basis adjustment would be required in both instances.

Elimination of capital gains taxation

The bill would eliminate taxes on all long-term capital gains resulting from the sale or exchange of property used in an enterprise zone in the active conduct of a trade or business, or from the sale or exchange of an interest in a qualified business. A qualified business would be a corporation, partnership or other entity at least 80 percent of the gross receipts of which were attributable to the active conduct of a trade or business (including rental of real estate) within an enterprise zone and substantially all the assets of which were located within a zone. Additionally, the bill would exclude enterprise zone capital gains from classification as tax preference items for purposes of the noncorporate and corporate minimum taxes.

Industrial development bonds

The December 31, 1986 termination of the "small issue" exception would be eliminated with respect to IDBs used to finance enterprise zone property and the provision restricting cost recovery deductions for property financed with IDBs would not apply with respect to enterprise zone property.

Tax simplification

The Internal Revenue Service would be required to simplify the administration of tax provisions added by this bill.

Title III. Regulatory flexibility

Upon request, Federal agencies and regulatory bodies could relax any regulatory requirements within zones, except requirements provided by statute or affecting civil rights, safety and public health.

Qualified businesses, any government nominating an area subsequently designated as an enterprise zone, and any not-for-profit enterprise operating within a zone would be accorded the same treatment under the Regulatory Flexibility Act as is now given to certain small entities.

Title IV. Foreign trade zones

Whenever possible, foreign trade zones could be established within enterprise zones.

Summary of S. 98

In general

S. 98 is very similar to S. 863, with two exceptions: (1) S. 98 does not contain the tax credit for zone employees and (2) S. 98 contains a provision allowing a deduction for purchase of stock in a zone business.

Deduction for enterprise zone stock

A taxpayer would be allowed to elect to deduct an amount equal to the purchase price of enterprise zone stock subject to a maximum of $100,000.

Summary of S. 634

Title I. Designation of revitalization areas

Revitalization areas would be designated by the Secretary of Housing and Urban Development after competitive review of State or local government nominations. Each nominated area would have to satisfy various criteria relating to economic, demographic and physical characteristics. A participating local government would be required to submit and follow a plan that specifies commitments to be made for the development of an area. The Secretary could designate revitalization areas during the 10-year period 1984–1993 and would be required to designate 205 areas according to a specified schedule during 1984–1988. A designation would remain in effect for 20 years, unless revoked by the Secretary.

Title II. Tax incentives

Revitalization area business

The bill would provide special tax incentives relating to revitalization area businesses. A revitalization area business would be defined as a business at least 50 percent of whose gross receipts are attributable to activities in a revitalization area and at least 30 percent of whose newly hired employees are qualified employees. Qualified employees would include individuals performing at least 50 percent of their services within a revitalization area and meeting various alternative standards of need. Special provisions would require that a business increase its overall activity in economically distressed areas to qualify as a revitalization area business.

Employee ownership tax credit

Revitalization area businesses, stock of which was owned by or in behalf of at least 70 percent of the corporation's employees (qualified corporations), could elect to claim a nonrefundable tax credit based on the amount of actual employee ownership. In general, the credit would be limited to the lesser of (1) the amount of the corporation's income tax liability reduced by certain other nonrefundable tax credits, or (2) $50,000.

Nonrecognition of gain on certain sales of stock to employees

No gain would be recognized on certain sales or exchanges of stock in revitalization area businesses by an individual to or with (1) leveraged ESOPs or tax credit ESOPs which invest primarily in stock issued by the revitalization area business and which meet certain nondiscrimination requirements; and (2) those revitalization area businesses which are producer cooperatives.

Rollover of gain reinvested in qualified property

The bill would provide for nonrecognition, or rollover, of gain on the sale or exchange of property if, within a specified period, the taxpayer purchased real or tangible personal property used or located in a revitalization area or an interest in a small revitalization area business (qualified property). The rule would apply only to the extent that the cost of the qualified property equalled or exceeded the amount of gain realized from the sale or exchange. The taxpayer's basis for the qualified property would be reduced by the amount of unrecognized gain.

Investment credit for low-income housing

An investment tax credit would be allowed for low-income rental housing located in a revitalization area.

Investment tax credit for entrepreneurial development centers

An investment tax credit would be allowed for establishing entrepreneurial development centers in a revitalization area.

Credit for employment of qualified employees

The bill would provide a revitalization area business with an elective tax credit equal to a percentage of qualified compensation paid to all newly hired qualified employees. Qualified compensation, with respect to any particular employee, would be a percentage of compensation that varies according to how long the employee has been employed by the revitalization area business. The credit would begin at a rate of 40 percent for compensation paid to employees who have been employed for less than one year, and would be fully phased out with respect to compensation paid to employees who have been employed for 4 years or more.

Deduction for income attributable to area business

A portion of the income attributable to a revitalization area business would be allowed as a deduction for purposes of computing taxable income.

Deduction for purchase of stock in area business

An individual would be allowed to deduct an amount equal to the purchase price of small revitalization area business stock or debentures subject to a maximum of $10,000 ($20,000 for a joint return).

Small business direct loans

Fifty million dollars of funds appropriated for small business direct loans would be allocated to small business concerns located in revitalization areas.

Amendments to targeted jobs tax credit

The bill would make the targeted jobs tax credit permanent. In addition, the bill would increase the amount of wages on which the credit is computed to $10,000 per employee per year.

Title III.—General stock ownership corporations

GSOCs similar to those that may be established under present law could be established in revitalization areas, with some modifications of the requirements. Among these changes, a revitalization area GSOC would have the authority to invest in real estate within the revitalization area.

Title IV.—Employee stock ownership plans

The bill would increase the allowable deduction limit for employer contributions to an ESOP from 25 percent of compensation to 50 percent of compensation, provided the increased contributions were applied to the repayment of principal amounts on loans incurred to acquire employer securities. In addition, the bill would permit an employer corporation to deduct certain dividends paid on employer securities held by an ESOP and would permit charitable deductions for purposes of the income, estate and gift taxes to certain individuals who contributed employer stock to an ESOP.

Title V.—Energy provisions

Residential energy credits

The bill would increase the tax credit for energy conservation expenditures from 15 to 40 percent after 1983. After December 31, 1985, the tax credits for energy conservation expenditures and renewable energy sources (which would then both be at 40 percent under the bill) would be available only for a residence located in a revitalization area.

Business energy credit

The bill would increase the tax credit for any energy investment property currently eligible to 30 percent for the period January 1, 1984 through December 31, 2002, in the case of a revitalization area business.

II. DESCRIPTION OF S. 863

(THE ENTERPRISE ZONE EMPLOYMENT AND DEVELOPMENT ACT OF 1983)

A. Designation of Enterprise Zones (Title I of the Bill)

Present Law

The Internal Revenue Code contains a provision which defines targeted areas for the purpose of promoting economic development within those areas. In section 103A, relating to mortgage subsidy bonds, some rules for issuance of mortgage subsidy bonds for targeted areas are not as restrictive as the generally applicable rules. These rules were enacted in the Mortgage Subsidy Bond Tax Act of 1980 (P.L. 96-499).

For purposes of mortgage subsidy bonds, a targeted area is either a qualified census tract or an area of chronic economic distress. A qualified census tract is a tract in which 70 percent or more of the families have income which is 80 percent or less of the statewide median income. Areas of chronic economic distress are to be designated by a State according to its standards, and the designation must be approved by the Secretaries of Treasury and Housing and Urban Development. In evaluating a State designation, the Secretaries must use as criteria (1) the condition of the housing stock, (2) the need for housing assistance as indicated by low per capita income, a high percentage of families in poverty, a high number of welfare recipients, and high unemployment rates, (3) the potential for designation to improve housing conditions in the area, and (4) the existence of a housing assistance plan which provides a displacement program and a public improvements and services program.

Several other provisions of the Code provide special tax treatment for specific areas. Section 4994(e) exempts crude oil produced in certain areas of Alaska from the windfall profit tax. In addition, certain domestic corporations deriving income from Puerto Rico and possessions of the United States (e.g., Guam) are eligible for a tax credit that eliminates the U.S. tax on that income. To qualify for the credit, the corporation must derive 80 percent or more of its gross income for the three immediately preceding years from sources within Puerto Rico or a possession of the United States and it must derive at least 65 percent of its gross income for that period from the active conduct of a trade or business within those countries. If a corporation meets these requirements, it is allowed a credit equal to the U.S. tax attributable to the corporation's trade or business related income derived from Puerto Rico or the possession.

Explanation of Provision

The bill would amend the Internal Revenue Code to provide criteria for the designation of enterprise zones.

1. Definition of enterprise zone

An enterprise zone would be any area which is nominated as an enterprise zone by one or more local governments and the State or States in which it is located, and which is approved by the Secretary of Housing and Urban Development (Secretary) after consultation with the Secretaries of Agriculture, Commerce, Labor, and the Treasury, the Director of the Office of Management and Budget, and the Administrator of the Small Business Administration. In the case of an enterprise zone on an Indian reservation, the Secretary of the Interior also would have to be consulted.

The term State would include Puerto Rico, the Virgin Islands, Guam, American Samoa, the Northern Mariana Islands, and any other possession of the United States. The term local government would include any county, city, town, township, parish, village or other general purpose political subdivision of a State, any combination of these subdivisions that is recognized by the Secretary, and the District of Columbia. In the case of a nominated area on an Indian reservation, the reservation governing body, as determined by the Secretary of the Interior, would be deemed to be both the State and local government.

Before designating any area as an enterprise zone, the Secretary would have to promulgate regulations, after consultation with the above Federal officials, describing (1) the nominating procedures, (2) the size and population characteristics of an enterprise zone, and (3) the procedures for comparing nominated areas using the criteria specified below for evaluating commitments made by State and local governments and for establishing priorities to be applied in making designations.

The Secretary could designate enterprise zones only during a 36-month period that begins on July 1, 1983, or the first day of the first month after the effective date of the regulations, whichever is later. (The tax benefits described below would be effective no earlier than January 1, 1984.) No more than 75 enterprise zones could be designated during this period. At least one-third of the zones designated would have to be areas which are outside a standard metropolitan statistical area or which are within a jurisdiction or jurisdictions of local government that have a population of less than 50,000 and are found by the Secretary (after consultation with the Secretary of Commerce) to be rural.

The Secretary could not designate an area as an enterprise zone unless the local government and the State in which the nominated area is located have the authority to nominate, to make commitments with respect to the zone, and to assure that the commitments will be fulfilled. Nominations would have to be submitted in the form, and with the information, required in the Secretary's regulations. The Secretary also would have to determine that the information submitted with a nomination is reasonably accurate and that no portion of the nominated area was already included in an enterprise zone or an area nominated as an enterprise zone.

2. Period of effect of designation

Under the bill, any enterprise zone designation would remain in effect from the date of designation to the earliest of December 31 of the calendar year 24 years later, the date stipulated by the State and local governments in their nomination application, or the date the zone designation is revoked by the Secretary. The Secretary, after consulting with the same Federal officials who must be consulted in designating enterprise zones, could revoke a zone designation if he determined that the State or local government was not substantially complying with the required State or local government commitments (described in 4, below).

3. Area requirements

The Secretary could designate an area nominated as an enterprise zone, only if it meets requirements concerning size, population, area boundaries, unemployment, poverty and other signs of economic distress. A description of these requirements follows:

a. The area must be within the jurisdiction of the local government seeking the designation and have a continuous boundary.

b. The most recent census must show that the area's population is at least 1,000 (4,000 if any part of the area, other than a rural area, is located in a metropolitan statistical area with 50,000 or more people) or the area must be entirely within an Indian reservation (as determined by the Secretary of the Interior).

c. The nominating governments must certify and the Secretary accept that the area is one of pervasive poverty, unemployment and general distress, and is located wholly within an area which meets the requirements for Federal assistance under section 119 of the Housing and Community Development Act of 1974, as in effect on the date of enactment.[1]

d. The nominating governments must certify and the Secretary accept that at least one of four additional requirements is satisfied: (1) the rate of unemployment, as determined by the appropriate available data, is at least 1½ times the national unemployment rate; (2) according to the most recent census data, each census tract in the area has a 20 percent or higher poverty rate (or each census county division, where not tracted); (3) at least 70 percent of the households living in the area have income below 80 percent of the median income of the households of the area within the jurisdiction of the local government which nominates the area (determined in the same manner as under section 119(b)(2) of the Housing and

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[1] Section 119 establishes a program of urban development action grants (UDAG) to severely distressed cities and urban counties to alleviate physical and economic deterioration through reclamation of neighborhoods. The eligibility of a city, or area within a city, generally is based on some or all of the city's or area's poverty rate, age of housing stock, growth in per capita income, growth in population, growth in retailing and manufacturing employment, unemployment rate, and income distribution (see Appendix for description of eligibility criteria).

Community Development Act of 1974); or (4) the population of the area has decreased by 20 percent or more between 1970 and 1980, as determined from the most recent census available.

4. Required State and local government commitments

Under the bill, no area would be designated as an enterprise zone unless the local government and the State in which it is located agreed in writing that, during any period that the area was an enterprise zone, these governments will follow a specified course of action designed to reduce the various burdens borne by employers or employees in the area.

This course of action could be implemented by the State and local governments and private nongovernmental entities, and could be funded from the proceeds of any Federal program. The course of action could include, but would not be limited to, (1) a reduction of tax rates or fees applying within the enterprise zone, (2) an increase in the level or efficiency of local services within the enterprise zone, particularly through experiments with the supply of these services by nongovernmental entities, (3) elimination, reduction or simplification of governmental requirements applying within the enterprise zone, and (4) program involvement by private entities, organizations, neighborhood associations and community groups, particularly those within the nominated area, including a commitment from these private entities to provide technical, financial or other assistance to, and jobs or job training for, employers, employees and residents of the area.

5. Priority of designation

The bill would provide criteria for the Secretary to use in choosing areas nominated to be enterprise zones. The Secretary would be required to give special preference to those nominated areas for which the strongest and highest quality contributions to a course of action (as described above) have been promised by the nominating governments, taking into account their fiscal ability to provide tax relief. The Secretary also would be required to give preference to nominated areas with the following characteristics: (1) strongest and highest quality contributions in addition to contributions under item 4 above; (2) most effective and enforceable guarantees provided by nominating State and local governments that proposed courses of action actually would be carried out for the duration of the designation; (3) high levels of poverty, unemployment and general distress, particularly areas near concentrations of disadvantaged workers or long-term unemployed individuals for whom employment would be a strong likelihood if the area were designated an enterprise zone; (4) zone size and location that would primarily stimulate new economic activity and minimize unnecessary Federal tax losses; (5) most substantial commitments by private entities of additional resources and contributions, including creation of new or expanded business activities; and (6) nominated zones which best exhibit such other factors, to be determined by the Secretary, that would be consistent with the program's intent and important in minimizing unnecessary loss of Federal tax revenues.

6. Evaluation and reporting requirements

The Secretary of Housing and Urban Development would be required to prepare and submit to Congress a report on the effects of designating qualifying areas as enterprise zones in accomplishing the purposes of the legislation. The first report would be submitted not later than the close of the fourth calendar year after the year in which areas are first designated as enterprise zones. Subsequent reports would be submitted at four year intervals.

7. Interaction with other Federal programs

a. General revenue sharing

Present Law

The general revenue sharing program, as authorized by the State and Local Fiscal Assistance Amendments of 1980 (P.L. 96-604), provides payments to local governments, on an entitlement basis, of $4.6 billion in both fiscal year 1982 and fiscal year 1983. Payments to State governments are authorized for these years, but are limited to the amount of categorical grant assistance that a State returns to the Federal Government. No funds have been appropriated under these State government authorizations and no regulations have been issued establishing procedures for returning grant funds to the Federal Government. Subject to few restrictions, State and local governments may use the funds for any purpose they deem appropriate.

The allocation of funds among State and local governments under the general revenue sharing program is determined under formulas which take into account several characteristics of the areas. These include population, urbanized population, per capita income, education spending, intergovernmental transfers, income tax collections, and total tax collections.

Explanation of Provision

Any reduction of taxes under any required program of local commitment under the enterprise zone program would be disregarded in determining the eligibility of a State or local government for, or the amount or extent of, any assistance or benefits under any law of the United States.

b. Uniform Relocation Assistance and Real Property Acquisition Policies Act of 1970

Present Law

The Uniform Relocation Assistance and Real Property Acquisition Policies Act of 1970 (P.L. 91-646) governs the responsibilities of Federal agencies which displace residents, businesses and farms because of an acquisition of real property or a requirement that property be vacated which is attributable to Federal or federally assisted projects or programs. Various forms of relocation assistance are provided under the Act. This assistance includes moving expenses, reimbursement of business losses, advisory services, and partial payments for or, under certain circumstances, actual provision of, replacement housing.

Explanation of Provision

Designation of an enterprise zone would not constitute approval of a Federal or Federally assisted program or project as those terms are used in the Uniform Relocation Assistance and Real Property Acquisition Policies Act of 1970. No person displaced from real property located in an area designated as an enterprise zone would have any rights or be entitled to any benefit pursuant to that Act as a result of such designation.

c. National Environmental Policy Act

Present Law

Under the National Environmental Policy Act, environmental assessments, and, if necessary, impact statements must be prepared with respect to certain Federal actions. These statements must include assessments of adverse environmental effects of proposed actions and, where appropriate, possible alternatives to these actions. Similar procedural requirements are required under other Federal environmental laws.

Explanation of Provision

Designation of an area as an enterprise zone would not constitute a Federal action for the purposes of applying the requirements of the National Environmental Policy Act or other provisions of Federal law relating to the protection of the environment. As a result, none of the Federal procedural requirements relating to environmental impact statements need to be met on account of the designation of an enterprise zone.

B. Tax Incentive Provisions (Title II of the Bill)

1. Tax credit for zone employers

Present Law

Overview

Under present law, there are no provisions under which an employer's Federal income tax liability varies according to the location of its employees or its change in employment. However, a provision in effect in recent years did provide a credit which varied with an employer's increased employment. In addition, the present law targeted jobs tax credit provides tax incentives for hiring specific groups of individuals.

Credit for increased employment (new jobs tax credit)

The Tax Reduction and Simplification Act of 1977 provided a new jobs tax credit for 1977 and 1978. The credit was 50 percent of the increase in each employer's wage base under the Federal Unemployment Tax Act (FUTA) above 102 percent of that wage base in the previous year. The FUTA base for 1977 consisted of wages paid of up to $4,200 per employee. The employer's deduction for wages was reduced by the amount of credit.

The total amount of the credit had four limitations: (1) the credit could not be more than 50 percent of the increase in total wages paid by the employer for the year above 105 percent of total wages paid by the employer in the previous year, (2) the credit could be not more than 25 percent of the current year's FUTA wages, (3) the credit for a year could not exceed $100,000, and (4) the credit could not exceed the taxpayer's tax liability. Credits which exceeded tax liability for a year could be carried back for 3 years and carried forward for 7 years.

Although most employers were able to use the returns they filed for purposes of complying with FUTA as a basis for claiming the credit, special rules were provided for businesses, such as farms and railroads, not covered under FUTA. Special rules also were provided for computation of the credit by groups of companies under common control, for businesses with employees working abroad, and for businesses affected by acquisitions, dispositions, and other changes in business form. Additional rules were provided for allocating the credit among members of a partnership and of a subchapter S corporation.

Targeted jobs tax credit

The targeted jobs tax credit, which applies to wages paid to eligible individuals who begin work for the employer before January 1, 1985, is available on an elective basis for hiring individuals from one or more of 9 target groups. The target groups are (1) vocational rehabilitation referrals; (2) economically disadvantaged youths aged 18 through 24, (3) economically disadvantaged Vietnam-era veterans; (4) Supplemental Security Income (SSI) recipients; (5) general assistance recipients; (6) economically disadvantaged cooperative education students; (7) economically disadvantaged former convicts; (8) AFDC recipients and WIN registrants; and (9) disadvantaged youths aged 16 or 17 for summer employment (effective for those who begin work for an employer after April 30, 1983).

The credit is equal to 50 percent of the first $6,000 of qualified first-year wages and 25 percent of qualified second-year wages paid to a member of a targeted group. Thus, the maximum credit is $3,000 per individual in the first year of employment and $1,500 per individual in the second year of employment. The employer's deduction for wages, however, must be reduced by the amount of the credit.

The credit is subject to several limitations. For example, wages may be taken into account for purposes of the credit only if more than one-half of the wages paid during the taxable year to an employee are for services in the employer's trade or business. In addition, wages for purposes of the credit do not include amounts paid to an individual for whom the employer is receiving payments for on-the-job training under a Federally-funded program.

For purposes of determining the years of employment of an employee and whether the $6,000 cap has been reached with respect to any employee, all employees of any corporation that are members of a controlled group of corporations are treated as if they are employees of a single corporation. Under the controlled group rules, the amount of credit allowed to the group is generally the same which would be allowed if the group were a single company. Comparable rules are provided for partnerships, proprietorships, and other trades or business (whether or not incorporated) under common control.

The credit may not exceed 90 percent of the employer's tax liability after being reduced by other nonrefundable credits. Excess credits may be carried back three years and carried forward fifteen years.

Explanation of Provision

In general

Under the bill, enterprise zone employers would be eligible to claim a tax credit equal to the sum of two parts—(1) an amount based on the increase in annual wages paid to employees working in the zone relative to wages paid to area employees in the period immediately before the area was designated as an enterprise zone, and (2) an amount based on wages paid in the current period to disadvantaged individuals working in the zone. The credit would be limited to the taxpayer's tax liability, and unused credit amounts could be carried back for 3 years or carried forward for the longer of 15 years or the remainder of the period during which the enterprise zone designation is in effect.

Qualified wages and qualified employees

The computation of the credit would be based on a definition of qualified wages paid to qualified employees.

Under the bill, a qualified employee would be any employee 90 percent or more of whose services directly relate to the conduct of the employer's trade or business located in an enterprise zone and who performs at least 50 percent of his service for the employer in an enterprise zone. A qualified employee would not include an employee with respect to whom the employer claims the targeted jobs credit.

Qualified wages generally would be defined to include amounts subject to FUTA (Federal Unemployment Tax Act), without regard to any dollar limit (currently $7,000 per year per employee). Special rules similar to those used in the targeted jobs credit would provide for wages paid in connection with agricultural and railway labor not covered by FUTA. Qualified wages for any period would not include any amount of federally funded on-the-job training payments the employer receives or is entitled to receive for a qualified employee for the period.

Increased enterprise zone employment

The first part of the credit would be equal to 10 percent of the excess of qualified wages paid or incurred during the taxable year to qualified employees in all enterprise zones over base period wages with respect to all zones. However, qualified wages could not be taken into account if they were taken into account in determining the amount of credit based on wages paid to economically disadvantaged individuals.

Base period wages, for any enterprise zone, would be the amount of wages which is paid during the 12-month period prior to zone designation, or, if earlier, the date on which the enterprise zone is designated under State law enacted after January 1, 1981, and which would have been qualified wages paid to individuals who would have been qualified employees if the designation had been in effect during this 12-month period. If the employer had no active trade or business in an area for which an enterprise zone designation was in effect for the taxable year for which the credit computation is made, base period wages for that enterprise zone would be zero.

Qualified wages taken into account for this portion of the credit could not exceed 2½ times the FUTA wage base in effect for the calendar year ending in the taxable year for which the credit computation is made. This limit would be used for the computation of base period wages as well as for the computation of current period qualified wages. If the FUTA wage base were increased, from one year to the next, then the amount of base period wages used in computing the credit in the second year would have to be recomputed to reflect the higher limit on the amount of wages per employee which could be taken into account.

The increased enterprise zone employment portion of the credit would be phased out starting in the taxable year of the taxpayer in which falls the twenty-first anniversary of the enterprise zone designation or, if earlier, the date 4 years before the date the zone designation was to expire. For this taxable year, the credit would be reduced to 7½ percent of qualified wages. The credit would then be reduced by 2½ percentage points for each succeeding year until fully terminated.

Disadvantaged individuals

The second part of the credit would be computed with respect to qualified wages paid to qualified employees who are qualified disadvantaged individuals.

This portion of the credit would be allowable for a total of seven years with respect to any qualified employee. The credit would be 50 percent of qualified wages paid to a qualified economically disadvantaged individual for services performed during the 36-month period beginning the day the individual began work in an enterprise zone for an employer. The credit would then be reduced 10 percentage points during each of the succeeding twelve-month periods, to 40 percent of qualified wages attributable to services rendered in the fourth year, 30 percent of qualified wages attributable to services rendered in the fifth year, 20 percent of qualified wages attributable to services rendered in the sixth year, and 10 percent of qualified wages attributable to services rendered in the seventh year. The credit with respect to any one employee would not be available after the seventh year of employment. These time periods would not take into account any period of time during which the individual is unemployed or any period of time during which the individual is employed by a taxpayer in an enterprise zone designated under a State law enacted after January 1, 1981, if this designation occurred prior to the Federal designation.

A qualified disadvantaged individual would be anyone who is hired during the period an enterprise zone designation is in effect for the area in which the services which qualify the individual as a qualified employee are performed and who is either a member of an economically disadvantaged family or a general assistance or AFDC recipient as defined for purposes of the targeted jobs credit. Thus, in the first alternative, the individual would have to be certified by the designated local agency as being a member of a family that had an income, including the cash value of food stamps, during the 6 months immediately preceding the month in which the determination occurs, which, on an annual basis, is equal to or less than the combined Aid to Families with Dependent Children (AFDC) and food stamp benefits available to a family of the same size with no countable income or resources. This combined benefit amount would be computed first by determining the highest amount which would ordinarily be paid under the AFDC program, in the State in which the family resides, to a family of the same size as the family being considered for tax credit eligibility. A family would not have to be of a type normally eligible for AFDC for the purposes of applying this standard. For example, the tax credit eligibility of a married couple with no children would be determined on the basis of the AFDC payment available to a single parent and one child, even though childless couples are not eligible for AFDC payments. Determinations throughout the entirety of each State would use the highest benefit amount available in any locality in the State to an assistance unit with no income and resources and with maximum need. The food stamp portion of the combined benefit amount then would be computed by assuming that the household's only income consists of AFDC benefits in the amount just determined, that the household consists only of the AFDC unit for which the computation is made (e.g., that there are no unrelated individuals living in the household), and that the family is entitled to the standard deduction and the maximum amount of other deductions which ordinarily are allowed to be household, the income of which consists entirely of AFDC benefits.

Alternatively, to be eligible for this portion of the tax credit, the individual would have to be certified as having been placed in employment under a work incentive program, or as receiving assistance under either the AFDC program for the 90-day period preceding the hiring date or under a general assistance program for not less than 30 days ending within the 60-day period ending on the day the individual is hired by the employer. Only those general assistance programs designated by the Secretary of the Treasury as consisting of money, voucher, or scrip payments based on need would be taken into account for this purpose. The Secretary would not designate any program designed specifically by a State or local government for enterprise zone residents in order to determine eligibility for this credit.

The credit amount would be reduced 25 percent in the first year in which the increased employment credit begins to phase out, and this reduction factor would be increased by 25 percent each year thereafter.

Other rules

Rules analogous to those contained in the present targeted jobs and research and experimental expenditures tax credits would control certification procedures and allocation and computation of the credit for controlled groups of businesses, for subchapter S corporations and their shareholders, for estate and trusts and their beneficiaries, and for employers affected by acquisitions and dispositions. Special rules also would be provided for taxpayers for which a zone designation is in effect only part of the taxable year or with a short taxable year.

Any credit taken with respect to an employee would be recaptured if the employee is terminated at any time during the first 270 days after the employee begins work for the employer, with certain exceptions, including voluntary termination, disability, or misconduct of the employee, or substantial reduction of the business. However, if the major portion of a trade or business, or the major portion of a separate unit of a trade or business of an employer were acquired by another employer, then employment of any qualified employee would not be terminated for purposes of this credit if the employee continued to be employed in that trade or business.

No deduction would be allowable to an enterprise zone employer for that portion of wages paid or incurred for the taxable year equal to the amount of credits allowable under this provision for the taxable year.

Effective Date

The provision would apply to taxable years beginning after December 31, 1983.

2. Tax credit for zone employees

Present Law

Under present law, the tax liability of an employee working in the United States generally does not vary according to the location of his employment. However, a refundable credit, the earned income credit, is allowed to certain low-income families with children.

Under the earned income credit provision, taxpayers living with children in the United States are eligible for a refundable tax credit equal to 10 percent of the first $5,000 of earnings. The maximum credit is $500. The maximum credit is reduced by 12.5 percent of the taxpayer's adjusted gross income (or if greater, earned income) in excess of $6,000. Thus, no credit is available to taxpayers with incomes of $10,000 or more.

Explanation of Provision

Under the bill, qualified employees would be entitled to claim a nonrefundable tax credit equal to 5 percent of qualified wages for the taxable year. For purposes of this credit, qualified wages would be equal to all remuneration paid for services of a qualified employee, but not including any compensation received from the Federal Government or any State or subdivision of a State, up to 1½ times the wage base in effect for the purpose of the Federal Unemployment Tax Act (FUTA) (currently $7,000). Thus, the maximum credit for any taxable year until the FUTA base is changed would be 5 percent of $10,500 or $525.

For purposes of this credit, a qualified employee would be an individual at least 90 percent of whose services are directly related to an enterprise zone trade or business and at least 50 percent of whose services are performed in an enterprise zone, and who is not an employee of the Federal Government or any State or local subdivision of any State. The determination of whether an individual was a qualified employee would be made separately with respect to each of the individual's employers.

The credit would phase out starting in the taxable year of the employee in which fell the twenty-first anniversary of enterprise zone designation, or, if earlier, the date 4 years before the date the zone designation is to expire, and would be phased out completely in four years.

Employers would be required to report to qualified employees the amount of wages paid to such employees.

Effective Date

The provision would apply in taxable years after December 31, 1983.

3. Investment tax credit for zone property

Present Law

Under present law, a regular investment tax credit is allowed for investment in tangible personal property and other tangible property (generally not including buildings or structural components) used in connection with manufacturing, production, or certain other activities. For eligible property in the 3-year recovery class, a 6-percent regular investment tax credit is allowed. For other eligible property, a 10-percent regular investment tax credit is allowed.

Buildings and their structural components generally do not qualify for the regular investment tax credit. However, in the case of qualified rehabilitation expenditures, a 15-percent tax credit is allowed for nonresidential buildings at least 30 years old, a 20-percent tax credit is allowed for nonresidential buildings at least 40 years old, and a 25-percent tax credit is allowed for certified historic buildings. The rehabilitation credit is allowed only for property that otherwise is not eligible for the investment tax credit. Unused investment tax credits may be carried back 3 years and carried forward for 15 years.

The basis of the asset, for such purposes as capital cost recovery deductions, is reduced by the full amount of the 15-percent or 20-percent rehabilitation tax credit and by half the investment tax credit for other types of property.

Explanation of Provision

Under the bill, an additional investment tax credit would be allowed for certain capital investments in an enterprise zone.

Zone personal property

In the case of property eligible for the regular investment tax credit (other than elevators and escalators), an additional 3-percent credit would be available for 3-year recovery property, and an additional 5-percent credit would be available for 5-year property, 10-year property and 15-year public utility property. In order to be eligible for this additional credit, such property would have to be acquired and first placed in service by the taxpayer in an enterprise zone during the period the designation as a zone is in effect. The property would not have to be new property. The taxpayer would have to use the property predominantly in the active conduct of a trade or business within an enterprise zone and could not acquire the property from a related person. Property used or located outside the enterprise zone on a regular basis would not be eligible for the additional credit. The credit rate would be reduced by 25-percent in the first year in which the employment credit begins to be phased out, and by an additional 25-percent each year thereafter.

New zone construction property

An additional 10-percent tax credit would be available for 15-year real property (including lodging) located in an enterprise zone if the property is acquired or constructed by the taxpayer and used predominantly in the active conduct of a trade or business, including the rental of real estate, within the enterprise zone. In the case of property acquired by the taxpayer, the additional credit would be available only if the property was acquired after designation of the zone and only if the original use of the property commenced with the taxpayer. In the case of property constructed, reconstructed, rehabilitated, renovated, expanded, or erected by the taxpayer, the credit would be available only to the extent of any construction or erection after designation of the enterprise zone. The credit rate would be reduced by 25 percent in the first year in which the employment credit begins to be phased out, and by an additional 25 percent each year thereafter.

The basis of property eligible for this additional 10-percent tax credit (15-year real property) would be reduced by the full amount of the additional credit allowable.

Recapture

If property for which an enterprise zone credit was claimed by a taxpayer ceases to be enterprise zone property of the taxpayer (other than by expiration or revocation of the designation of the zone), a portion of the enterprise zone credit would be recaptured. Property would cease to be enterprise zone property of a taxpayer if, for example, the taxpayer disposed of the property, removed the property from the enterprise zone, or ceased to use the property in the active conduct of a trade or business within the enterprise zone.

The amount of the enterprise zone credit subject to recapture would be the difference between the amount of credit allowed for the property and a recomputed credit based on the amount of time the property was enterprise zone property of the taxpayer. The recomputed credit would bear the same ratio to the amount of credit originally allowed as the number of taxable years in which the property was enterprise zone property of the taxpayer bears to the number of years over which the property is depreciated for purposes of computing earnings and profits. The recapture periods would be as follows:

	Years
3-year property	5
5-year property	12
10-year property	25
15-year public utility property	35
15-year real property	35

Thus, for example, no enterprise zone credit would be recaptured with respect to 3-year recovery property if it remained enterprise zone property of the taxpayer for 5 taxable years. If this property had been enterprise zone property of the taxpayer for only 4 taxable years, 20 percent of the enterprise zone credit would be recaptured.

Carryover period

Unused investment tax credit amounts attributable to the additional enterprise zone percentage could be carried forward for the remaining life of the enterprise zone or 15 years, whichever is longer.

Effective Date

The provision generally would apply to periods after December 31, 1983.

4. Elimination of capital gains taxation

Present Law

In general

Under present law, gain or loss from the sale or exchange of a capital asset receives special tax treatment. For this purpose, the term "capital asset" generally means any property held by the taxpayer. However, capital assets generally do not include (1) inventory, stock in trade, or property held primarily for sale to customers in the ordinary course of the taxpayer's trade or business, (2) depreciable or real property used in the taxpayer's trade or business, (3) specified literary or artistic property, (4) business accounts or notes receivable, or (5) certain U.S. publications. Although depreciable personal property and real property used in a trade or business are not capital assets, gains from sales or exchanges of those assets may be treated as capital gains under certain circumstances.

Noncorporate capital gains deduction

Noncorporate taxpayers may deduct from gross income 60 percent of the amount of any net capital gain (the excess of net long-term capital gain over net short-term capital loss) for the taxable year. (Long-term capital gain is defined as gain from the sale or exchange of a capital asset held for more than one year). The remaining 40 percent of the net capital gain is included in gross income and taxed at the otherwise applicable regular income tax rates. As a result, the highest tax rate applicable to a noncorporate taxpayer's entire net capital gain is 20 percent, i.e., 50 percent (the highest individual tax rate) times the 40 percent of the entire net capital gain includible in adjusted gross income.

Corporate capital gains tax

An alternative tax rate of 28 percent applies to a corporation's net capital gain (the excess of net long-term capital gain over net short-term capital loss) if the tax computed using that rate is lower than the corporation's regular tax. (The highest regular corporate tax rate is 46 percent for taxable income over $100,000.)

Minimum taxes

"Add-on" minimum tax

Present law imposes an "add-on" minimum tax for corporations on certain tax preference items. 18/46ths of a corporation's net capital gain is a tax preference subject to the minimum tax.

Alternative minimum tax

Under present law, noncorporate taxpayers are subject to an alternative minimum tax to the extent that it exceeds their regular income tax. The alternative minimum tax is based on the taxpayer's adjusted gross income, as reduced by allowed deductions, and increased by tax preference items, including the 60 percent of net capital gains deducted in computing the regular tax. The alternative minimum tax rate is 20 percent for amounts in excess of a specified exemption amount.

Explanation of Provision

The bill would eliminate taxes on long-term capital gains resulting from the sale or exchange of (1) property used in an enterprise zone in the active conduct of a trade or business or (2) an interest in an enterprise zone "qualified business." Additionally, the bill would exclude enterprise zone capital gains from classification as tax preference items for purposes of the noncorporate and corporate minimum taxes.

Qualified property and qualified business

The bill would eliminate tax on gain from sales or exchanges of "qualified property" otherwise eligible for long-term capital gain treatment. For this purpose, the term "qualified property" would mean (1) tangible personal property used predominantly by the taxpayer in an enterprise zone in the active conduct of a trade or business in a zone, (2) real property located in an enterprise zone and which is used predominantly by the taxpayer in the active conduct of a trade or business in a zone and (3) an interest in a corporation, partnership, or other entity if, for the three most recent taxable years of the entity ending before the date of disposition of the interest, the entity was a "qualified business."

Under the provision, the term "qualified business" would mean any person (1) actively engaged in the conduct of a trade or business (including rental of real estate) during the three most recent taxable years, (2) at least 80 percent of the gross receipts of which for the taxable year are attributable to the active conduct of a trade or business within an enterprise zone, and (3) substantially all of the tangible assets of which are located within an enterprise zone.

Under the bill, gain from the sale or exchange of an interest in a qualified business would not be treated as gain from the sale or exchange of qualified property to the extent the gain was attributable to (1) any property contributed to the qualified business within the previous 12 months, (2) any interest in a business which is not a qualified business, (3) any gain allocable to a period when the property is not qualified property, or (4) any other intangible property not properly allocable to an active trade or business within an enterprise zone.

Under the bill, the special tax treatment for gain from sales or exchanges of qualified property would not cease to be available upon the termination or revocation of an area's designation as an enterprise zone. However, the treatment would not apply after the first sale or exchange of any item of qualified property after the designation ceases to apply.

Noncorporate capital gains deduction

The bill would allow a noncorporate taxpayer to deduct from gross income 100 percent of any long-term capital gain from qualified property.

Corporate capital gains tax

The bill would allow a corporation to exclude from taxation all long-term capital gain from qualified property.

Tax preferences for minimum tax purposes

The bill would eliminate net capital gains attributable to qualified property from classification as a tax preference item for purposes of the corporate and noncorporate minimum taxes.

Effective Date

The provision would be effective for sales or exchanges after December 31, 1983.

5. Industrial development bonds

Present Law

Interest on State and local government obligations generally is exempt from Federal income tax (obligations issued after June 30, 1983, must be in registered form to be exempt). However, subject to certain exceptions, interest on State and local issues of industrial development bonds is taxable. An obligation constitutes an industrial development bond (IDB) if (1) all or a major portion of the proceeds of the issue are to be used in any trade or business of a person other than a governmental unit or tax-exempt organization described in sec. 501(c)(3) and (2) payment of principal or interest on which is secured by an interest in, or derived from payments with respect to, property or borrowed money used, or to be used, in a trade or business.

Present law provides an exception which exempts from tax interest on IDBs that are issued to finance the following types of exempt activities: (1) projects for low-income residential rental property, (2) sports facilities, (3) convention or trade show facilities, (4) airports, docks, wharves, mass commuting facilities, and parking facilities, (5) sewage and solid waste disposal facilities, and facilities for the local furnishing of electricity or gas, (6) air or water pollution control facilities, (7) certain facilities for the furnishing of water, (8) qualified hydroelectric generating facilities, and (9) qualified mass commuting vehicles. In addition, the interest on certain IDBs issued for the purpose of acquiring or developing land as a site for an industrial park is exempt from taxation.

Present law also provides an exception for certain "small issues" to the general rule of taxability of interest paid on industrial development bonds. This exception is not available for bond proceeds used for golf courses, country clubs, racetracks and other specified types of facilities. This exception applies to issues of $1 million or less if the proceeds are used for the acquisition, construction, or improvement of land or depreciable property.

At the election of the issuer, the $1 million limitation may be increased to $10 million. If this election is made, the exception is restricted to projects where the aggregate amount of outstanding exempt small issues and capital expenditures (financed otherwise than out of the proceeds of exempt small issues) made over or a six-year period does not exceed $10 million. Both the $1 million and $10 million limitations are determined by aggregating the face amount of all outstanding related issues, plus, in the case of the $10 million limitation, certain capital expenditures for all facilities used by the same or related principal users which are located within the same county or same incorporated municipality.

In general, the small issue exemption will not apply with respect to obligations issued after December 31, 1986.

Under present law, to the extent that certain facilities are financed by an IDB and the property is placed in service after December 31, 1982, such property generally is allowed cost recovery deductions at a slower rate than those allowed under ACRS or other accelerated cost recovery provisions of the Code. In lieu of deductions under ACRS, the cost of property financed with IDBs must be recovered using the straight-line method over the ACRS life for the property involved. This limitation applies to both the first owner of the property and to any subsequent owners who acquire the property while the IDBs (including any refunding issues) are outstanding.

However, the cost of the following types of facilities financed in whole or in part with IDBs may continue to be recovered under ACRS: low-income rental housing, municipal sewage and solid waste disposal facilities, air or water pollution control facilities used in connection with a plant or other property in operation before July 1, 1982, and facilities for which a UDAG grant equalling or exceeding 5 percent of the total capital expenditures on the facility is made.

Explanation of Provision

The bill provides that the provision of present law which restricts the cost recovery deductions for property financed with tax-exempt bonds would not apply to enterprise zone property eligible for the additional investment credit described above (item II.B.3).

The bill also provides that the provision of present law which terminates the small issue exception after December 31, 1986, would not apply to any obligation which is part of an issue substantially all of the proceeds of which are used to finance facilities placed in service in an area for which an enterprise zone designation is in effect.

Effective Date

The provisions would apply to obligations issued after December 31, 1983 in taxable years ending after such date.

6. Tax simplification

Present Law

In the past, the tax law has imposed various simplification requirements. For example, the Tax Reform Act of 1976 required the Joint Committee on Taxation to conduct a study of simplification of the tax law.[1] In addition, the Revenue Act of 1978 required the Treasury Department to conduct a study of simplification of income tax forms and instructions.[2]

Under present law, one of the duties of the Joint Committee on Taxation is to investigate measures and methods for the simplification of the tax laws (Code sec. 8022(2)).[3]

Explanation of Provision

The bill would provide that it is the sense of the Congress that the Internal Revenue Service should, in every way possible, simplify the administration and enforcement of the tax provisions added to the Internal Revenue Code by this bill.

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[1] Sec. 507 of P.L. 94-455. The report, *Issues in Simplification of the Income Tax Laws*, was submitted in September 1977.

[2] Sec. 551 of P.L. 95-600.

[3] For example, at the request of the Joint Committee, the U.S. General Accounting Office conducted a study on simpliification of income tax forms and issued a report entitled *Further Simplification of Income Tax Forms and Instructions Is Needed and Possible* (GAO Report No. GGD-78-74; July 5 1978). The General Accounting Office has conducted numerous other tax administration studies in recent years for the Joint Committee and other congressional committees.

C. Regulatory Flexibility (Title III of the Bill)

Present Law

The Regulatory Flexibility Act (5 USC secs. 602–612) requires Federal regulatory agencies to publish analyses of the economic impact on entities under its coverage of any proposed regulations and to discuss alternatives to those regulations. The Act requires Federal regulatory agencies to undertake a periodic review of their regulations to determine whether they should be changed to minimize their economic impact on the entities covered by the Act.

In general, the purpose of the Regulatory Flexibility Act is to require Federal agencies to fit regulatory and informational requirements to the scale of the businesses, organizations, and governmental jurisdictions subject to regulation. To achieve this goal, agencies are required to solicit and consider flexible regulatory proposals and to explain the rationale for their actions to assure that such proposals are given serious consideration. The Act requires that special attention is to be given to small entities. For example, in its initial regulatory flexibility analysis, an agency must describe the impact of a proposed rule on small entities.

Small entities, for purposes of the Regulatory Flexibility Act, are small businesses (generally independently owned and operated business enterprises that are not dominant in their fields of operation), small organizations (independently owned and operated not-for-profit enterprises that are not dominant in their fields), and small governmental jurisdictions (governments of cities, towns, townships, villages, school districts, or special districts, with populations of less than fifty thousand).

Explanation of Provisions

Designation of zone entities of small entities for purposes of analysis of regulatory functions

The bill would expand the definition of a small entity, for purposes of the Regulatory Flexibility Act, to include any qualified zone business, any government designating an area as an enterprise zone to the extent any regulatory rule would affect the zone, and any not-for-profit enterprise operating within an enterprise zone.

Waiver or modification of agency rules in enterprise zones

Under the bill, Federal agencies and regulatory bodies would be given discretionary authority to relax or eliminate any regulatory requirements within enterprise zones except those affecting civil rights, safety and public health, or those required by statute, including any requirement of the Fair Labor Standards Act. This authority could be exercised only upon request of State and local governments.[1] Agencies would make their determinations on requests not later than 90 days after their receipt. Such waivers or determinations would not be considered a rule, rulemaking, or regulation under the Administrative Procedure Act.

Coordination of Housing and Urban Development Programs in enterprise zones

The bill would provide that the Secretary of Housing and Urban Development would be required to promote the coordination of programs under his jurisdiction and carried on in an enterprise zone and to consolidate requirements for related applications and reports required under these programs.

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[1] Examples of regulations which could be relaxed include regulations governing exports, regulations affecting accounting treatment of loans made by national banks, regulations affecting inventory accounting for tax purposes, regulations affecting issuance of securities, and regulations affecting various energy performance, coal conversion, and conservation regulations.

D. Establishment of Foreign Trade Zones in Enterprise Zones (Title IV of the Bill)

Present Law

Each port of entry is entitled to at least one foreign trade zone. In a foreign trade zone, foreign merchandise may be received by a company, and the merchandise is not considered to have entered U.S. Customs territory. Thus, dutiable goods may be received free of duty. These goods may be stored, sold, repaired, assembled, distributed, manufactured and displayed within the zone, and then exported or sent into Customs territory of the United States. When sent into Customs territory, the goods become subject to the laws affecting imported merchandise, such as the levy of customs duties.

Foreign trade zones are authorized by the Foreign Trade Zone Board, a Federal agency chaired by the Secretary of Commerce. Such zones typically consist of specific factories, warehouses, or industrial parks.

Explanation of Provision

The bill would require the Foreign Trade Zone Board to expedite on a priority basis the processing and approval, to the maximum extent practicable, of any application involving the establishment of a foreign trade zone within an enterprise zone. The Secretary of the Treasury would be required to give the same urgent consideration to an application for establishment of a port of entry necessary to permit the establishment of a foreign trade zone within an enterprise zone.

E. Revenue Effects of the Bill

The effect of S. 863 on budget receipts will depend on the number, size, and characteristics of the zones designated by the Secretary of Housing and Urban Development. Because the bill provides the Secretary with wide latitude in his choice, it is extremely difficult to provide specific cost estimates for these provisions.

The Treasury Department estimates that these provisions will reduce fiscal year receipts by $0.1 billion in 1984, $0.4 billion in 1985, $0.8 billion in 1986, $1.1 billion in 1987 and $1.1 billion in 1988. These estimates are based on particular assumptions about the size and characteristics of the zones. However, these assumptions are not mandated by the provisions of this bill, and, thus, these figures may either underestimate or overestimate the actual revenue loss by a considerable degree.

Treasury's estimates are based on the assumption that the zones selected by the Secretary of Housing and Urban Development would have, at the time of designation, average employment, other than in governments and non-profit institutions, of 7,000 persons and a mix of economic activities similar to those of a sample of distressed areas in several cities. The language of the bill does not require this average employment and economic mix, however, so that the above figures may not estimate the actual revenue loss. If the average zone has, for example, only 3,500 employees, then actual revenue losses would be $0.04 billion, $0.2 billion, $0.4 billion, $0.5 billion, and $0.6 billion in fiscal years 1984 through 1988, respectively, if the assumptions about the economic mix were correct.

On the other hand, several factors could make the actual revenue loss higher than the Treasury estimates. First, the actual mix of economic activities in the zone or attracted to the zone could be very payroll intensive and have a high ratio of investment to payroll, substantially increasing the cost of the tax incentives relative to what was assumed.

Second, the Treasury estimate assumes designation of the 75 zones ratably over the 1984–1986 period. If a higher proportion of the zones were designated in the earlier portion of this period, the revenue loss would be larger in all the above years.

Third, because of data limitations, the Treasury estimates do not take into account losses associated with investments in rental housing and other rental real estate and investments by public utilities.

Fourth, the average size of zones when they are actually designated by the Secretary could be much larger than an average taxable employment of 7,000. If, for example, employment in designated zones were to average 35,000 and the economic mix were the same as assumed by Treasury, fiscal year revenue losses would be $0.4 billion in 1984, $2.0 billion in 1985, $3.8 billion in 1986, $5.3 billion in 1987 and $5.7 billion in 1988.

III. DESCRIPTION OF S. 98

(THE ENTERPRISE ZONE EMPLOYMENT AND DEVELOPMENT TAX ACT OF 1983)

A. Overview

S. 98 is very similar to S. 863 with two exceptions: (1) S. 98 does not contain the tax credit for zone employees and (2) S. 98 contains a provision allowing a deduction for purchase of stock in a zone business (described below).

B. Deduction for Purchase of Stock in Zone Business

Present Law

For purposes of computing taxable income, items may be deducted from gross income only when specifically authorized. When income is generated by a business enterprise, the ordinary and necessary expenses paid or incurred in carrying on the trade or business generally are allowed as deductions from such business income. When income is derived from the sale or other disposition of a capital asset, the amount of gain or loss includible in taxable income is generally the amount received from the sale or other disposition less the taxpayer's adjusted basis in the property. Gains from the sale of a capital asset (capital gains) are accorded certain preferential tax treatment. However, capital losses are given less generous treatment than other losses (ordinary losses).

Under present law, a special rule is provided for an individual who invests in certain small business stock (section 1244 stock). If an individual incurs a loss on section 1244 stock that would otherwise be treated as a capital loss, such loss is treated as an ordinary loss. For purposes of this provision, section 1244 stock must generally be common stock in a domestic corporation in which the capital and paid-in surplus does not exceed $1 million and, for the 5 years prior to the date of the loss, receives less than 50 percent of its income from passive sources.

Explanation of Provision

Under the bill, a taxpayer would be allowed to elect to deduct amounts paid to a qualified issuer for the purchase of enterprise stock. Only the original purchaser would be allowed this deduction. The maximum amount deductible by a taxpayer (and its related persons) could not exceed $100,000. To the extent that a taxpayer pays more than this amount for the purchase of enterprise stock in any taxable year, the maximum deduction would be allocated pro rata to the stock in accordance with the purchase price of each share. The basis of the stock would be reduced by the amount of the deduction allowed. In cases in which stock is received in exchange for property in a transaction in which the basis of the stock is determined by reference to the taxpayer's basis in the property, the deduction would be reduced by the excess (if any) of the adjusted basis of the stock over its fair market value. Purchase of the stock would be treated as made during the taxable year, provided that payment is made not later than the time for filing of the taxpayer's tax return (including extensions) for that year and the taxpayer is subject to a binding contract to purchase the stock on the last day of the taxable year. For this purpose, stock is not considered purchased if acquired in a nontaxable transaction governed by sections 351, 361, or 371.

For purposes of this deduction, enterprise stock would be shares of common stock (1) which are purchased from the qualified issuer when originally issued, and (2) the proceeds from the issuance of which are used in a qualified business. A qualified issuer would be a corporation, other than a subchapter S corporation, that (1) is actively engaged in the conduct of a trade or business within an enterprise zone; (2) has at least 80 percent of its gross receipts for the year attributable to its activity within the enterprise zone; (3) has substantially all of its tangible assets located within the enterprise zone; (4) in combination with its related persons, does not have a net worth exceeding $2 million before or immediately after receipt of the enterprise stock issued; (5) which has currently, or has had within the 5 most recent taxable years, no securities outstanding that are subject to regulation by the Securities and Exchange Commission and which has no related person with such securities outstanding; and (6) which during the period of the 5 most recent taxable years derived more than 50 percent of its gross receipts from sources other than passive sources.

Proceeds from the sale or other disposition (whether taxable or nontaxable) of enterprise stock would be treated as ordinary income to the extent of the deduction previously allowed. This gain would be recognized notwithstanding any nonrecognition provisions in the law. In addition, if the enterprise stock is held by the taxpayer for a period of less than 3 years, a stock recapture tax would be imposed on the taxpayer. The amount of the stock recapture tax would be equal to the amount of interest (computed from the date of purchase to the date the stock is disposed of at the rate imposed on tax deficiencies) owing on the reduction in tax liability resulting from this deduction.

If the qualified issuer of the enterprise stock fails to meet the qualification requirements in the year the stock is issued or any of the 4 taxable years subsequent to the year of issue, the taxpayer would have to include as ordinary income the amount of this deduction allowed. In addition, a tax would be imposed on the taxpayer equal to the amount of interest (at the rate imposed on tax deficiencies) which would be owed for the holding period on the reduction in tax liability resulting from this deduction. For purposes of this recapture tax which would result from the issuer ceasing to qualify, the holding period would be the period from the date of purchase of the stock until the earlier of (1) the date of issuance of securities by the qualified issuer that are subject to regulation by the Securities and Exchange Commission, or (2) the end of the issuer's taxable year in which the issuer fails to meet the qualification requirements.

Effective Date

The provision would be effective upon enactment.

IV. DESCRIPTION OF S. 634

(THE COMMUNITY ASSISTANCE AND REVITALIZATION ACT OF 1983)

A. Designation of Revitalization Areas (Title I of the Bill)

Present Law

The Internal Revenue Code contains several provisions which provide special tax treatment in specific geographic areas. (See description in II.A., above).

Explanation of Provisions

This title of the bill would provide rules for the designation of revitalization areas.

1. Definition of revitalization areas

A revitalization area would be any area in the United States or its possessions that is nominated by the appropriate State government and designated a revitalization area by the Secretary of Housing and Urban Development (Secretary), after consultation with the Administrator of the Small Business Administration and the Secretaries of Commerce, Labor and the Treasury. A local government could nominate an area if its State government fails to nominate within 60 days after a request to do so.

The Secretary would be required to prescribe regulations, not later than 180 days after the date of enactment, providing the form, manner and schedules for filing applications.

The Secretary could designate revitalization areas at any time after 1983 and before 1994, and would be required to designate 30 areas in 1984, 30 in 1985, 35 in 1986, 45 in 1987, and 65 in 1988.

2. Period of effect of designation

In general, a revitalization area designation would remain in effect for the 20-year period which begins on the date of designation. However, the Secretary, after consulting the same Federal officials who must be consulted in designating revitalization areas and providing the opportunity of a hearing for the participating local government, could revoke a designation at an earlier date, if he determined that the local government was not substantially complying with its revitalization area development plan (described below).

3. Area and development plan requirements for preliminary approval

The Secretary could not give final approval of a designation without having first given preliminary approval. This preliminary approval could be given only if the area meets certain requirements and the participating local government submits a revitalization area development plan, has established a revitalization area management authority, and has consulted residents and organizations located in the area.

A description of the area requirements follows:

a. The area must be within the jurisdiction of the participating local government, have a continuous boundary that includes, if feasible, proximately located vacant or underutilized land or buildings conveniently accessible to area residents, and comprise at least 1 square mile.

b. The most recent census must show that the area's population is at least 2,500 (4,000 if any part is located in a standard metropolitan statistical area with 50,000 or more people) or the area must be an Indian reservation (as determined by the Secretary of the Interior).

c. The Secretary must determine that the area is one of pervasive poverty, unemployment and general distress.

d. At least one of four additional requirements must be satisfied: (1) the average rate of unemployment in the area for the most recent 18 months is at least 1½ times the nationwide rate; (2) the area is a low-income poverty area, as determined by the most recent census; (3) at least 60 percent of the area's residents have incomes below 80 percent of the median income of residents of the participating local government (determined as under section 119(b) of the Housing and Community Development Act of 1974); or (4) aggregate population in census tracts in the area decreased by 10 percent or more between 1970 and 1980 and chronic abandonment, demolition or substantial tax arrearages of structures exists in the area.

The revitalization area development plan would assess conditions, specify and assign priority to development objectives, provide for a revitalization area management authority and specify its powers, and provide advisory guidelines for the making and evaluating of investment and development decisions. The plan would specify how residents' equity ownership of property would be affected by development, evaluate aspects of the labor market (including job, entrepreneurial and managerial resources) in the area and specify any commitments to assist in meeting the needs of residents and businesses. In addition, the plan would evaluate the needs, resources and potential of small, minority, and ownership-expanding businesses in the area and specify any commitments to be made by State and local governments or others to assist in meeting the needs of these businesses. (In general, an ownership-expanding business would mean a revitalization area business which is a producer cooperative or has an employee stock ownership plan, whose nonmanagerial employees own at least a 35-percent interest in the business, and which annually distributes as bonuses at least 10 percent of its profits to its employees.) The plan also would evaluate the status of efforts and provide commitments to improve energy efficiency in the area. Furthermore, the plan would specify any commitment, among others, to limit residential displacement and related problems, to have at least 10 percent of the proceeds of industrial development bonds issued during a year by a participating local government be used by revitalization area businesses (especially small, minority, or ownership-expanding businesses) to assist entrepreneurship of minorities and youths, to maintain and increase the availability of low-income and moderate-income housing, to streamline government regulations not directly related to health and safety, to improve public services, to reduce local government fees, taxes or other expenses for businesses located in the area, and to use, as much as practicable, revitalization area businesses to provide public services within the area.

4. Requirements for final approval

The Secretary could give final approval to the designation of an area as a revitalization area only if he had given it preliminary approval and found that the participating local government had taken adequate measures for fulfilling the commitments made in the revitalization area development plan.

5. Priority of designation

In choosing the areas to designate, the Secretary would be required to give preference to areas with the highest levels of general distress and with respect to which the participating local government demonstrates the most comprehensive and determined commitment to pursue its revitalization area redevelopment plan (judged in part by the breadth of support among residents and various organizations). In addition, the Secretary would be required to consider both the area's economic ability to make commitments in its development plan and the extent to which an application corresponds to any State plan for revitalizing distressed areas.

6. Coordination with other Federal programs

The Secretary of Housing and Urban Development would be assigned responsibility to promote coordination within a revitalization area among all Federal housing, community and economic development, banking, financial assistance and employment training programs. The Secretary also would be instructed to consolidate application forms in order to expedite consideration of program applications and to consolidate periodic reports required under the programs.

7. Job training preferences

Agency heads would be required to give certain preferences in the granting of Federal funds or contracts to any programs, organizations or local governments for the purpose of job training. The following preferences are stipulated in the bill: (1) any program, organization, or local government located or primarily serving in a revitalization area; (2) programs and organizations that are part of a revitalization area job training plan; and (3) community-based organizations or entrepreneurship development centers located in or primarily serving a revitalization area. A community based organization would be a tax-exempt organization which has demonstrated effectiveness in the delivery of employment and training services.

Each agency head would be required to take actions to assure that recipients of Federal funds or contracts for job training give special consideration to the above preferences in any further distribution of the funds.

B. Tax Incentives (Title II of the Bill)

1. Definition of revitalization area business

Explanation of Provision

A "revitalization area business" would be defined as a taxable entity at least 50 percent of whose gross receipts for the taxable year are attributable to the active conduct of a trade or business which produces goods, or provides services, within a revitalization area. Additionally, at least 30 percent of the employees hired by a revitalization area business after it begins to conduct business within a revitalization area (or, if later, after designation of the revitalization area) would have to be qualified employees.

"Qualified employees" would include any individual who performs at least 50 percent of his services within a revitalization area and who, immediately prior to employment by the revitalization area business, (1) had been unemployed for at least 10 weeks and was economically disadvantaged; (2) had a family income (exclusive of unemployment compensation and welfare payments) which did not exceed the lower living standard income level as determined by the Department of Labor for the applicable location and family size; (3) was (or whose family was) receiving supplemental security income or aid to families with dependent children; or (4) in the case of nonhandicapped individuals, was between 14 and 22 years of age and economically disadvantaged (or a member of an economically disadvantaged family) and required additional education, training, or counseling to secure meaningful employment. A person would be considered "economically disadvantaged" if he or his family receives (or his family income would be low enough to qualify for) Federal, State or local cash welfare payments, if he is a foster child on whose behalf State or local government payments are made, if he is a handicapped or institutionalized individual, or if he or his family has received, for the 6-month period prior to employment with the revitalization area business, total family income not in excess of the higher of (1) the poverty level determined in accordance with the criteria established by the Office of Management and Budget, or (2) 60 percent of the lower living standard income level. For purposes of defining qualified employees, persons working in jobs providing insufficient income to support their families (as determined pursuant to regulations) would be considered to be unemployed. The term "family" would include all dependents claimed by an individual on his Federal income tax return for the year prior to the year in which the individual became employed by the revitalization area business.

For a previously existing business to qualify as a revitalization area business, it would be required to employ, during the taxable year, an average number of full-time employees at least 10 percent greater than it employed during the taxable year preceding the designation of the revitalization area. If the commencement or increase of activity by a business in a revitalization area was related to a cessation or curtailment of activity by such business in a distressed area (as identified by the Department of Housing and Urban Development), the business would not be treated as a revitalization area business unless it maintained its new level of activity in the revitalization area during the 3-year period after the commencement or increase and the business was owned by substantially the same persons during this period (without regard to any change in ownership resulting from an employee ownership plan).

2. Employee ownership tax credit

Present Law

Under present law, an employer who maintains a tax-qualified employee stock ownership plan (ESOP) is permitted a deduction (within limits) for contributions to the plan. In addition, if the employer contributes additional cash or securities to an ESOP which qualifies as a tax credit ESOP, the employer may be entitled to a payroll based tax credit for contributions to the plan.

Explanation of Provision

The bill would permit qualified corporations to elect to claim a new nonrefundable employee ownership tax credit, equal to an applicable percentage of the corporation's taxable income. The credit would be based on actual employee ownership, whether or not the employer maintained an ESOP.

The applicable percentage for any taxable year would be a percentage equal to the product of (1) 2 percent, and (2) the number of multiples of 10 percent in the employee ownership percentage for the taxable year. The bill defines the employee ownership percentage as a percentage determined by dividing the total number of shares of voting stock of the qualified corporation owned by, or on behalf of, qualified employees (see definition in item 1, above) on the last day of the taxable year by the total number of shares of voting stock outstanding on the last day of the taxable year.

The amount of the credit would be subject to a number of limitations. First, the maximum amount of the credit allowed for any taxable year could not exceed $50,000. For this purpose, component members of a controlled group are treated as a single taxpayer; the Secretary of the Treasury is authorized to prescribe regulations providing for the allocation of the $50,000 credit among the component members. Second, the maximum amount of the credit would be limited to the taxpayer's income tax liability, reduced by certain other nonrefundable credits. Third, no corporation which elects to claim the payroll based tax credit for contributions to a tax credit ESOP may elect to take the new employee ownership tax credit.

For purposes of this credit, the bill defines a qualified corporation as a revitalization area business (see item 1, above), stock of which is owned by or on behalf of at least 70 percent of the corporation's employees.

Effective Date

The provision would apply to taxable years ending after December 31, 1983.

3. Nonrecognition of gain on certain sales of stock to employee plans

Present Law

Under present law, gain or loss from the sale or exchange of a capital asset receives special tax treatment (see description in item II.B.4. above).

Explanation of Provision

Under the bill, no gain would be recognized from certain sales or exchanges of stocks in a revitalization area business. Transactions eligible for this nonrecognition treatment would include—

(1) qualifying sales or exchanges of stock in a revitalization area business by a taxpayer to or with a leveraged ESOP or tax credit ESOP which invests primarily in stock issued by that revitalization area business; and

(2) sales or exchanges of stock in a revitalization area business by a taxpayer to or with a revitalization area business which is a producer cooperative.

Under the bill, a producer cooperative is defined as an organization which is chartered and operated on a cooperative basis for the purpose of furnishing goods or services which are primarily consumed by persons other than the members of such organizations; and which provides that all employees are members of the organization.

Sales or exchanges to or with a leveraged ESOP or tax credit ESOP would qualify for nonrecognition treatment under this provision only if the following additional requirements are met:

(1) at least 51 percent of the total number of shares sold or exchanged by the taxpayer to or with the plan must be allocaed to the accounts of nonmanagerial employees;

(2) at least 51 percent of the total shares of stock in the revitalization area business held by the plan must be allocated among at least 51 percent of the nonmanagerial employees;

(3) if the sale or exchange is to or with a tax credit ESOP, all employees to whom the shares are allocated must receive a nonforfeitable right to those shares within 5 years after the date of the sale; and

(4) the taxpayer must maintain such records and provide such information to the Secretary of the Treasury as the Secretary may by regulations require.

For purposes of these provisions, nonmanagerial employees include all employees other than those who are officers or those whose compensation exceeds a specified dollar limit ($60,000 for 1983).

Effective Date

The provision would apply to taxable years ending after December 31, 1983.

4. Rollover of gain reinvested in qualified property

Present Law

Under present law, gain or loss from the sale or exchange of a capital asset receives special tax treatment.

Present law generally does not categorize gains or losses with regard to the location of an asset, or the specific purpose for which it is used. In certain instances, however, present law allows nonrecognition, or rollover, of gain from the sale of property, such as a taxpayer's principal residence, to the extent that the proceeds are reinvested in a specified manner. In these instances, the rules operate to defer, rather than eliminate, tax on the sale of the asset.

Explanation of Provision

The bill would provide for nonrecognition of gain on the sale or exchange of property by a taxpayer if the taxpayer purchases qualified property within a period beginning 3 months prior to the date of the sale or exchange and ending 21 months after that date. The rule would apply only to the extent of the cost of the qualified property.

"Qualified property" would include (1) tangible personal property acquired by the taxpayer after designation of a revitalization area, and used predominantly by the taxpayer in that area in the active conduct of a trade or business; (2) real property located in a revitalization area, which was acquired by the taxpayer after designation of the area and used predominantly by the taxpayer in the active conduct of a trade or business; and (3) stock of a corporation, or an interest in a partnership or other business, if, for the most recent taxable year ending before the date of acquisiton of such interest, the business was a small revitalization area business (defined as a revitalization area business having average annual gross receipts not exceeding $4,000,000 over a 3-year period). Additionally, qualified property would include certain forms of low-income rental housing which is located in a revitalization area and which was built, or significantly rehabilitated, after the designation of the area.

Under the bill, the special treatment for sales or exchanges of qualified property would not terminate when the designation of the revitalization area in which the property was used or located ceased to apply. However, the special treatment would not apply after the first sale or exchange of the property after the designation ceased to apply.

If gain on the sale or exchange of property was not recognized because the taxpayer acquired qualified property, the taxpayer's basis in the qualified property would be the cost of the qualified property decreased by the amount of unrecognized gain. The rule would thus defer tax on the unrecognized gain.

Effective Date

The provision would apply to taxable years ending after December 31, 1983.

5. Investment tax credit for certain low-income rental housing

Present Law

An investment tax applies to eligible tangible personal property used in a trade or business or for the production of income (see description in item II. B. 3, above).

Explanation of Provision

A 10-percent investment tax credit would be allowed for investment in certain low-income rental housing located in a revitalization area. For purposes of this credit, low-income rental housing generally would include any building, financed with subsidized financing, in which the dwelling units are rented to families and individuals of low or moderate income who are eligible to receive subsidies from the Federal Government or any State. In addition, similar property designated by the Secretary of Housing and Urban Development could qualify as low-income rental housing. In order to be eligible for this credit, the property would have to be located in an revitalization area and constructed or rehabilitated after designation of the area. Property would not cease to be qualified solely as a result of the fact that the designation of the area as a revitalization area ceases. The cost of the rehabilitation would have to be at least $10,000 per unit with respect to each project (or $3,000 in the case of certain State or local agency financed projects).

Effective Date

The provision would apply to periods after December 31, 1983.

6. Investment tax credit for establishment of enterpreneurial development centers

Present Law

An investment tax credit applies to eligible tangible personal property used in a trade or business or for the production of income (see description in item II.B.3, above).

Explanation of Provision

An investment tax credit would be allowed for the establishment of an enterpreneurial development center. For purposes of this credit, an entrepreneurial development center would mean a facility which (1) is located in a revitalization area; (2) is placed in service within 24 months after establishment of the area; (3) is privately owned and operated for profit; (4) provides advice to revitalization area businesses regarding management techniques, financing, marketing, taxation, job training, and other matters; (5) maintains a professional staff to provide such advice; (6) employs at least one employee or consultant with expertise in the legal, managerial, and financial needs of a variety of businesses; (7) provides physical resources such as machinery, computer services, laboratories, and office space; (8) consults with the local government regarding the needs of the businesses within the revitalization area; and (9) charges a reasonable fee for the services provided by the center.

The amount of the investment credit would be 10 percent of the expenditures incurred to establish the entrepreneurial development center, but could not exceed $750,000. Special rules would apply to the allocation of the credit limitation between members of a controlled group.

The bill would provide a special rule to prevent recapture of the investment tax credit when an area ceases to be designated as a revitalization area.

Effective Date

The provision would apply to periods after December 31, 1983.

7. Tax credit for employment of qualified employees

Present Law

Under present law, there are no provisions under which an employer's Federal income tax liability varies according to the location of its employees. The targeted jobs credit provides a tax credit for a portion of wage payments made to certain groups of employees (see description in item II.B.1, above).

Explanation of Provision

The provision would allow a revitalization area business to elect to take a nonrefundable credit against tax equal to the aggregate qualified compensation paid to all revitalization area employees of the business during the taxable year. A revitalization area employee would be a qualified employee (see definition in item IV.B.1, above) who is hired by the revitalization area business after the later of either (1) the date on which the revitalization area business begins the active conduct of a trade or business within a revitalization area, or (2) the date on which any area in which the revitalization area business is actively engaged in the conduct of a trade or business is designated as a revitalization area.

For purposes of the provision, qualified compensation, with respect to any revitalization area employee, would be an amount equal to the applicable percentage of the aggregate compensation paid by the revitalization area business to such employee during the taxable year of the business.

The applicable percentage would vary, in accordance with the following table, depending upon how long the employee has been employed by the business:

If at the end of the taxable year the employee has been employed by the business for:	*The applicable percentage is:*
Less than 1 year	40
At least 1 year but less than 2 years	30
At least 2 years but less than 3 years	20
At least 3 years but less than 4 years	10
4 years or more	0

A taxpayer would not be permitted to take both this credit and the deduction for income attributable to revitalization areas. (see description in item IV.B.8 below). Additionally, the credit would not be available for any employee with respect to whose not be available for any employee with respect to whose wages credit has been allowed for any taxable year under the targeted jobs credit (see item II.B.1 above).

Effective Date

The provision would be effective for taxable years ending after December 31, 1983.

8. Deduction for certain income attributable to businesses operating in revitalization areas

Present Law

The tax treatment of income from a business operating within the United States generally does not depend on the location of the business. However, the Internal Revenue Code contains several provisions which provide special tax treatment in specific geographic areas (see description in item II.A., above).

Explanation of Provision

A portion of the income received by a taxpayer from (1) the active conduct of a trade or business in a revitalization area, and (2) certain financing provided to revitalization area businesses would be allowed as a deduction. The proportion of this income allowed as a deduction (applicable percentage) would be based on the percentage (qualified employee percentage) of all employees of the business who are qualified employees (see description in item 1, above), as follows:

Qualified employee percentage	*Applicable Percentage*
Less than 30	0
At least 30 but less than 40	20
At least 40 but less than 50	30
At least 50 but less than 60	40
60 or more	50

Effective Date

The provision would apply to taxable years ending after December 31, 1983.

9. Deduction for purchase of revitalization area business stock and debentures

Present Law

For purposes of computing taxable income, a deduction generally is not allowed for purchases of stock or debentures. However, special rules are provided for the deduction of losses recognized on certain small business stock (see description in item III. B., above).

Explanation of Provision

An individual, or partnership of individuals, would be allowed to deduct an amount equal to the purchase price of small revitalization area business stock or debentures for the purpose of computing taxable income. Only the original purchaser would be entitled to this deduction. The maximum amount allowable as a deduction could not exceed $10,000 ($20,000 in the case of a joint return). Purchase of the stock or debentures would be deemed to have been made on the last day of the taxable year provided that payment is made not later than the time for filing of the return (including extensions) for that year. The basis of the stock or debentures would be reduced by the amount of the deduction allowed. In cases in which stock or debentures are received in exchange for property in a transaction in which the basis of the stock or debentures determined by reference to the taxpayer's basis in the property, the deduction would be reduced by the excess (if any) of the adjusted basis of the stock or debentures over its fair market value.

For purposes of this deduction, revitalization area business stock or debentures would mean common stock or written debt instruments issued by a qualified revitalization area business issuer. The written debt instrument would have to be a general obligation of the issuer, bear a rate of interest not less than an amount prescribed by regulations, and have a fixed maturity.

A qualified revitalization area business issuer would mean a revitalization area business (1) of which the average annual gross receipts do not exceed $4 million for the 3-taxable-year period ending with the taxable year; (2) which has no securities outstanding which are subject to regulation by the Securities and Exchange Commission; and (3) which during the period of its 5 most recent taxable years derived more than 50 percent of its income from sources which are not passive sources. For purposes of determining whether a business qualifies as a revitalization area business, the outstanding stock or debentures of all members of a controlled group would be taken into account.

Proceeds from the sale of revitalization area business stock or debentures would be recaptured as ordinary income to the extent of the deduction previously allowed if the sale occurred before the close of the 3-year period beginning on the date of purchase. Otherwise, the character of the gain or loss from the sale of the stock or debentures would be determined under generally applicable principles.

Effective Date

The provision would apply to taxable years ending after December 31, 1983.

10. Direct loans under the Small Business Act to revitalization area businesses

Present Law

Loans may be made under the Small Business Act to small business for plant acquisition, construction, conversion, or expansion, including acquisition of land, materials, supplies, equipment, and working capital, and to make loans to any qualified small business concern, including those owned by qualified Indian tribes. The financings may be made either directly or in cooperation with banks or other financial institutions through agreements to participate on an immediate or deferred (or guaranteed) basis. The amounts available for the loans must be made available in advance through appropriation Acts.

Explanation of Provision

At least $50 million of the amount appropriated for new direct loan obligations under the Small Business Act would be required to be obligated with small business concerns located in revitalization areas.

11. Amendments to targeted jobs tax credit

Present Law

The targeted jobs tax credit provides a credit equal to a portion of the first $6,000 of wages per year paid to employees who are members of specific targeted groups and who begin work for the employer before January 1, 1985. (See description in item II.B.1., above.)

Explanation of Provision

The bill would increase amount of wages on which the targeted jobs tax credit is computed to $10,000 per year per employee.

In addition, the targeted jobs tax credit would be made permanent.

Effective Date

The provision increasing the first-year credit would apply to wages paid after the date of enactment in taxable years ending after such date.

The provision making the credit permanent would be effective upon enactment.

C. General Stock Ownership Provisions (Title III of the Bill)

Present Law

Under the Internal Revenue Code, a State is authorized to establish a General Stock Ownership Corporation (GSOC) for the benefit of all its citizens who would be the shareholders. A GSOC may borrow money to invest in business enterprises and use the net flow of cash from operations to service and repay the loan and to distribute the remaining funds to the GSOC shareholders.

Definition of GSOC

A corporation must meet certain statutory tests in order to be treated as a GSOC. First, the corporation must be chartered by an official act of the State legislature or by a State-wide referendum. Second, the GSOC's corporate charter must provide for the issuance of only one class of stock, the issuance of shares only to eligible individuals and the issuance of at least one share to each eligible individual if such eligible individual does not elect within one year after the date of issuance not to receive such share. The Act also requires the charter to provide for certain restrictions on the transferability of the GSOC shares. The transfer restriction must provide that the share cannot be transferred until the earliest of (1) the expiration of 5 years from issuance, (2) death, or (3) failure to meet the State's residency requirements. In no event may shares of stock of a GSOC be transferred to nonresidents. Also, no person may acquire more than 10 shares of the GSOC's stock. Third, the GSOC must not be empowered to invest in properties acquired by it or for its benefit through the right of eminent domain. Fourth, the GSOC may not be affiliated with any other corporation. For this purpose, a 20 percent ownership test will apply to determine affiliated status rather than the customary 80 percent test. Fifth, the GSOC must be organized after December 31, 1978, and before January 1, 1984.

An eligible individual is any individual who is a resident of the chartering State as of the date specified in the enabling legislation and who remains a resident between that date and the date of issuance of the stock. A State may define a resident for purposes of its GSOC so long as such definition is consistent with constitutional principles.

Election by GSOC

A GSOC must make an election to obtain the special statutory treatment provided for by the amendment. The election is effective for the taxable year for which it is made. The manner in which the election is to be made is to be determined by regulations promulgated by the Department of the Treasury. (Regulations relating to GSOCs have not been promulgated.) The election once made is irrevocable unless terminated with the consent of the Secretary of the Treasury. In addition, the election is terminated if the corporation ceases to qualify as a GSOC.

The effect of the election is to exempt the corporation from Federal income taxation. Instead, the shareholders of the GSOC would report their proportionate part of the GSOCs taxable income on their Federal individual income tax returns.

Other rules for GSOC

Treated as a private corporation.—A GSOC is treated as a private corporation for Federal income tax purposes.

Computation of GSOC income.—The GSOC computes its taxable income in the same manner as a regular corporation with certain modifications. The GSOC is not eligible for a dividends received deduction nor any tax credit.

Net operating loss deduction.—The shareholders of a GSOC are not eligible to report any portion of a GSOC net operating loss on their individual income tax returns. Instead, the GSOC is entitled to a 10-year carryover of any net operating loss.

Investment tax credit and recapture of investment tax credit.—Shareholders of the GSOC are entitled to their pro rata share of the GSOC's investment tax credit. The shareholders are also personally responsible for any recapture of the investment tax credit. Neither the corporation nor its shreholders is entitled to the foreign tax credit.

Distribution requirements.—A GSOC is required to distribute 90 percent of its taxable income for any taxable year to its shareholders by January 31, of the next succeeding year. To the extent a GSOC fails to meet this distribution requirement, a tax equal to 20 percent of the deficiency (i.e., the difference between the required distribution and the actual distribution) is imposed on the GSOC. The amount of such tax will be allowed as a deduction to the GSOC for the year in which it is paid rather than the year of accrual.

Taxation of GSOC shareholders

Each shareholder includes in his gross income his daily pro rata portion of the GSOC's taxable income. Such income is included in the shareholder's gross income for the taxable year in which or with which the GSOC's taxable year ends. The income in the hands of the shareholder is treated as ordinary income and is not eligible for the partial dividend exclusion.

Shareholders will increase the tax basis of shares of stock in the GSOC by the amount of the GSOC taxable income which is taxed to the shareholders. This basis adjustment is made by a shareholder only to the extent an amount is actually included in gross income in his or her income tax return (unless under section 6012(a)(1), the shareholder is not required to file a return).

Explanation of Provisions

1. Definition of revitalization area GSOC

A revitalization area GSOC would be chartered by the State legislature or Governor, under terms specified in the bill, to serve the needs of each specific revitalization area and would be authorized by its charter to acquire and develop real estate in the area. The charter would provide for issue of stock only to eligible revitalization area residents. Each share would have full voting rights. An eligible area resident would be at least 18 years old, and an area resident for at least 1 continuous year.

Eligibility for holding of shares would be prescribed for exempt and non-exempt area residents. Exempt residents could include employees of the area GSOC, individual volunteers of services for the GSOC, and disabled individuals. Each exempt resident could own 25 percent more shares than each non-exempt resident. A resident could sell stock only to the revitalization area GSOC, beginning 5 years after the date the stock is issued or when the shareholder ceases to be a resident of the revitalization area. A share could be transferred by will or by the laws of descent and distribution at any time.

The definition of the GSOC in present law is amended to pertain also to a revitalization area GSOC. The present law provision is extended to apply to GSOCs chartered before 1995.

2. Establishment of revitalization area GSOC

A planning board would be elected within 180 days after designation of the revitalization area to decide whether to establish a GSOC. The decision would have to be made within a year of the designation. A favorable decision would result in application for a charter that would be issued by the State legislature or the Governor. The bill contains rules regarding election of a planning board and, subsequently, a board of directors.

The GSOC board of directors within 90 days would have to submit a business plan which specifies (1) the objectives of the revitalization area GSOC, (2) the type of investments that could be made by the GSOC, and (3) the manner in which the revitalization area GSOC proposes to develop the area. The plan would have to be approved by a majority of the shareholders before any action to develop the revitalization area could be taken.

3. Other provisions

A GSOC that owns stock in a real estate corporation would not be considered as a member of an affiliated group unless it owns 80 percent of each class of voting and nonvoting stock. A real estate corporation for these purposes would have to derive at least 95 percent of its gross income from rents or gains from the sale or distribution of real property during any taxable year in which a GSOC owns at least 20 percent of its stock.

A revitalization area GSOC would be required to distribute at least 10 percent of its taxable income for any taxable year.

Contributions to a GSOC by an individual would be treated as charitable contributions.

Only 50 percent of the gain realized from the sale or exchange of any property to, or with, a revitalization area GSOC would be recognized.

Effective Date

These provisions would generally apply to taxable years ending after December 31, 1983.

D. Employee Stock Ownership Provisions (Title IV of the Bill)

1. Overview of present law

An employee stock ownership plan (ESOP) is a tax-qualified plan under which employer stock is held for the benefit of employees. The stock, which is held by a tax-exempt trust under the plan, may be acquired through direct employer contributions or with the proceeds of a loan to the trust.

An ESOP which borrows to acquire employer stock is referred to as a leveraged ESOP. Under a leveraged ESOP, the employer makes contributions to the trust and is allowed a deduction, within limits, for contributions applied to pay off the loan.

An employee stock ownership plan under which an employer contributes stock or cash in order to qualify for an additional tax credit based on a a percentage of payroll is referred to as a tax credit ESOP. The payroll based tax credit applies with respect to compensation paid or accrued before January 1, 1988.

Under the usual rules applicable to tax-qualified plans, an employee's benefits under an ESOP are generally not taxed to the employee until they are distributed or made available. Also, the Code provides special 10-year income averaging for lump sum distributions, deferral of tax on appreciation in employer securities, and estate and gift tax exclusions.

2. Deductible contributions to leveraged ESOP's

Present Law

An employee stock ownership plan which borrows to acquire employer stock is referred to as a leveraged ESOP. Under a leveraged ESOP, the employer is allowed a deduction, within limits, for contributions to the plan which may be applied by the plan to service the loan.

The deduction allowed an employer for contributions to a profit-sharing or stock bonus plan (including a leveraged ESOP) generally is limited to 15 percent of the aggregate compensation of all employees under the plan. However, in the case of a leveraged ESOP consisting of a stock bonus plan and a money purchase pension plan, the deduction for employer contributions to qualified plans for a year generally is limited to 25 percent of the aggregate compensation of employees covered by the plans (sec. 404(a)(7)). In addition, annual contributions and certain other additions (including forefeitures) credited to a participant's account under qualified defined contribution plans of an employer (including a leveraged ESOP) generally may not exceed the usual limits on contributions to qualified plans for 1983, the lesser of $30,000 or 25 percent of the participant's compensation. In the case of certain ESOPs, the dollar limit is doubled.

The allowable deduction limit is increased for certain employer contributions applied by the plan to the payment of loans to purchase employer securities. Amounts applied to the payment of interest on a qualifying loan are allowed as a deduction without regard to an annual percent-of-compensation limit (sec. 404(a)(10)(B)). However, the deduction allowed for contributions applied to the repayment of loan principal is limited to 25 percent of the compensation of all employees under the plan (sec. 404(a)(10)(A)).

Those additional ESOP contributions which are applied by the plan to the payment of interest on a loan to acquire employer securities (but not amounts applied to loan principal), as well as any forfeitures of employer securities purchased with loan proceeds, generally are not taken into account under the rules providing overall limits on contributions and benefits under qualified plans (sec. 415(c)(6)). The rule allowing the employer contributions of loan interest and the employee forfeitures to be disregarded for purposes of the overall limitations applies only if no more than one-third of the employer's contributions for the year is allocated to the group of employees consisting of officers, shareholders directly or indirectly owning more than 10 percent of the employer's stock (other than stock held by qualified plans), or individuals whose compensation exceeds a specified limit.

Explanation of Provision

The bill would increase the allowable deduction limit for certain employer contributions applied by the plan to the payment of loans to purchase employer securities. Under the bill, the maximum deduction allowed for contributions applied to the repayment of loan principal would be increased from 25 percent to 50 percent of the compensation of all employees under the plan.

In addition, with respect to employer contributions applied to the payment of principal, the percentage limit applied by the overall limits on contributions and benefits would be increased from 25 to 50 percent of compensation. Under the bill, although annual additions on behalf of any participant generally would be limited to the lesser of 25 percent of compensation or the applicable dollar limit ($30,000 for 1983), that percentage limit would be increased to 50 percent if the increased annual additions resulted from employer contributions applied to the repayment of principal. No change would be made to the dollar limit.

Effective Date

The provision would apply to taxable years ending after December 31, 1983.

3. Treatment of dividend distributions

Present Law

Under present law, a corporation generally is not entitled to deductions for dividends paid to shareholders.

Explanation of Provision

Under the bill, a corporation would be entitled to a deduction for dividends paid during the taxable year on employer securities held (as of the record date) by a leveraged ESOP or a tax credit ESOP, provided that the dividends received by the plan are (1) distributed to the employees participating in the plan not later than 60 days after the end of the plan year in which they are received, or (2) applied by the plan to the repayment of a loan incurred to acquire employer securities.

Under the bill, a corporation also would be entitled to a deduction for dividends paid during the taxable year on employer securities held (as of the record date) by a former employee or beneficiary who received the securities in a distribution from a leveraged ESOP or a tax credit ESOP.

Effective Date

The provision would apply to taxable years ending after December 31, 1983.

4. Charitable contributions

Present Law

Under present law, a corporate employer is allowed, within certain limits, a business expense deduction for contributions to certain tax-qualified plans (including ESOPs). No person other than the employer is allowed any deduction (including charitable deductions) for such a contribution.

Explanation of Provision

Under the bill, an individual could make a contribution or bequest of employer securities to a leveraged ESOP or a tax credit ESOP, and such a contribution could qualify as a charitable contribution for purposes of the income, estate and gift taxes. Thus, those amounts would be deductible (subject to the otherwise applicable limitation on the amount of deductible charitable contributions).

To qualify, the gift or contribution would have to meet several conditions:

(1) the contribution or gift must consist exclusively of employer securities;

(2) the contribution or gift must be allocated (pursuant to the terms of the ESOP) in a nondiscriminatory fashion to the plan participants;

(3) no portion of the contribution or gift may be allocated under the plan for the benefit of the donor, or any person related to the donor (within the meaning of section 267(b)) or any person who owns more than 25 percent in value of any class of outstanding employer securities;

(4) the contribution or gift must be made pursuant to the terms of the leveraged ESOP or tax-credit ESOP;

(5) the plan must treat the donated securities as attributable to employer contributions; and

(6) no tax deduction or tax credit may be permitted to the employer with respect to such gift.

Conforming changes are made to the estate and gift tax provisions which permit charitable deductions.

Effective Date

The provision would apply to taxable years ending after December 31, 1983.

E. Energy Provisions (Title V of the Bill)

1. Residential energy tax credit

Present Law

A tax credit of 15 percent of up to $2,000 of qualified energy conservation expenditures with respect to a dwelling unit which is the taxpayer's principal residence may be taken against individual income tax liability. Qualified energy conservation expenditures include insulation, a furnace replacement burner, a device to modify flue openings, an electrical or mechanical furnace ignition system, storm or thermal exterior windows or doors, an automatic energy-saving setback thermostat, caulking or weatherstripping for exterior doors or windows, and an energy usage display meter.

A tax credit of 40 percent is available for expenditures up to $10,000 on renewable energy source property for any dwelling unit which is the taxpayer's principal residence. Renewable energy source property provides heating and cooling from solar, wind, geothermal and other renewable energy sources.

These credits apply to expenditures for qualified property made before January 1, 1986. Unused credits may be carried over to succeeding taxable years through December 31, 1987.

Explanation of Provision

The tax credit for energy conservation expenditures would be increased to 40 percent.

After the termination date in present law, December 31, 1985, the energy conservation and renewable energy tax credits would be available only for any dwelling unit within a revitalization area. Unused credits attributable to energy expenditures in revitalization areas could be carried forward through December 31, 2004.

Effective Date

The increase in the amount of credit would apply to taxable years ending after December 31, 1983.

The provision extending the credit in revitalization areas would apply to taxable years ending after December 31, 1985.

2. Increase in energy investment tax credit for revitalization area businesses

Present Law

Energy investment tax credits that vary between 10 and 15 percent presently are allowable for solar, wind or geothermal property, ocean thermal property, qualified hydroelectric generating property, qualified intercity buses, and biomass property.

These credits are scheduled to expire after December 31, 1985.

Explanation of Provision

The energy investment tax credit would be increased to 30 percent with respect to any energy property of a taxpayer which is a revitalization area business for the taxable year.

This provision would apply to eligible property for the period beginning January 1, 1984, through December 31, 2002.

Effective Date

The provision generally would apply to periods after December 31, 1983.

APPENDIX:

Area Eligibility Criteria for Urban Development Action Grants (UDAG)

The Urban Development Action Grant (UDAG) program provides grants for economic revitalization and neighborhood reclamation projects. The projects must be located in jurisdictions or areas which meet certain minimum standards of physical and economic distress and which demonstrate provision of housing for low and moderate income individuals and equal opportunity in housing and employment. Currently, more than 350 cities of population over 50,000 and more than 8,000 smaller cities are eligible for UDAG grants, either in whole or in part.

Area eligibility factors

The statute authorizing the program specifies six factors to be taken into account in determining an area's eligibility, and the Secretary of Housing and Urban Development provides by regulation the numerical levels of these factors which are required for eligibility. The six factors currently in effect are as follows:

a. Poverty rate.—At least 10.87 percent of the population of the jurisdiction have incomes at or below the poverty level, based on 1970 Census data; for small cities (categories 2 and 3, below), at least 11.99 percent, based on 1980 Census data.

b. Age of housing.—At least 33.98 percent (33.81 in small cities) of the jurisdiction's year-round housing units were constructed prior to 1940, based on U.S. Census data.

c. Growth in per capita income.—The net increase in per capita income for the period 1969 to 1977 must have been $2,683 or less, based on U.S. Census data; for small cities, the net increase in per capita income for the period 1969–1979 must have been $4,062 or less.

d. Population growth.—For the period 1970–1980, the population growth must have been 1.13 percent or less in cities of under 50,000 population, or 19.82 percent or less in larger cities or urban counties for the period 1960–1980.

e. Employment growth in retailing and manufacturing.—The rate of growth in retail and manufacturing employment for the period 1972 to 1977 must have been 6.75 percent or less; for small cities greater than 25,000 in population, 6.84 percent or less.

f. Unemployment rate.—The 1981 unemployment rate must have been at least 7.24 percent, based on Bureau of Labor Statistics data.

Population criteria

Eligibility of areas depends on their population:

1. Cities over 50,000.—A city with a population of at least 50,000, a central city of a metropolitan statistical area, or an urban county must meet at least three of the above six criteria. If the poverty rate is less than half the figure above (item (a)), then the area must meet at least four of the remaining five criteria.

2. Cities of population between 25,000 and 50,000.—Cities with population between 25,000 and 50,000 must meet at least three of the first five criteria. If the poverty rate is less than half the figure above (item (a)), then the area must meet all four of the criteria (b) through (e), above. If the poverty rate is at least double the figure above (item (a)), the city also must meet only one of the criteria (b) through (e), above. If the percentage of housing units constructed prior to 1940 is at least double the figure above (item (b)), then the city also must meet only the poverty rate criterion (item (a)).

3. Cities of population under 25,000.—A city under 25,000 must meet three of the first four criteria (items (a) through (d)). If the poverty rate is at least double the figure in item (a) above, then the city must meet only one of the other three criteria. If the percentage of housing units constructed prior to 1940 is at least double the figure above (item (b)), then the city must also meet only the poverty rate criterion (item (a)).

4. Areas within ineligible cities.—Severely distressed areas within otherwise ineligible communities may be designated as "pockets of poverty" and thus made eligible. The area must be composed of contiguous census tracts, enumeration districts or block groups. In cities of population over 50,000, the area must contain at least 10,000 persons or 10 percent of the jurisdiction's population, whichever is lower. For smaller cities, the area must contain the greater of 2,500 persons or 10 percent of the jurisdiction's population. For all cities, no enumeration district or block group with a median income level greater than 120 percent of the jurisdiction's median income may be included in the pocket of poverty. In addition, at least 70 percent of the households in the area must have incomes below 80 percent of the jurisdiction's median income, and at least 30 percent of area residents must have incomes below the poverty level.

The **Chairman**. We will now commence hearings on enterprise zone legislation. I am pleased that Senator Chafee is arriving, Senator Heinz is here and we have an outstanding Member of the House to be our first witness. I would just like to say a couple of words, Bob, and then we will recognize you.

I certainly appreciate having this early opportunity to review President Reagan's enterprise zone proposal, as resubmitted to the 98th Congress. I might point out, this is the third time that the Finance Committee has had the opportunity to consider enterprise zones in hearings.

In 1980, hearings were held on legislation introduced by Senators Chafee and Boschwitz, and last spring another hearing was held on the administration's initial proposal. Both hearings were conducted by our distinguished colleague from Rhode Island, Senator Chafee, in the Subcommittee on Savings, Pensions and Investment Policy.

It was largely due to the leadership that he and Senator Boschwitz have shown in this area that our committee reported out legislation last fall to implement the President's program for economic redevelopment.

As everyone knows, we weren't able to proceed with that legislation in the 97th Congress, but we hope, by moving with more speed and earlier this year, and with the hope that the House will do the same, we can pass this legislation some time in mid-year.

So we are certainly pleased to have the hearings today. We have had this legislation before us. It has been shaped and reshaped several times. Certain parameters seem to have been set. It seems generally agreed that at least at the outset, enterprise zones would be a limited program to give us experience with reducing tax and regulatory burdens on a discrete basis to improve the prospects for economic development.

I have had an opportunity in Toledo and other areas to see some of the work being carried on by States and by local communities and by the private sector, and it seems to me that it is high time that we take action.

I can assure those who have an interest in enterprise zones that this committee, under the leadership of Senator Chafee, will make this a high priority this year. I would be happy to yield to Senator Chafee if he would like to make a statement, and Senator Heinz.

Senator **Chafee**. Thank you very much, Mr. Chairman.

First of all, I would like to thank you for the interest that you have shown on this issue over many years. It is our hope that this year we can proceed with this legislation, not only out of the full committee, as you arranged last year, but also floor action and final passage. Your help has been of tremendous assistance throughout this long effort.

The witnesses who are here today are people who have given a lot of thoughtful attention to this. Senator Boschwitz is the prime sponsor of the legislation this year, and Representative Garcia, who is before us, has appeared at different forums around the country. This issue is of particular importance to the very area that he represents, the Bronx in New York State. He has given a lot of attention to this issue and, with Representative Kemp, introduced the legislation in the House.

I will be interested in his testimony and how he thinks things are coming over in the House.

I have a statement here, Mr. Chairman, which I submit for the record. Again, I want to thank you.

[The statement of Senator Chafee follows:]

STATEMENT OF SENATOR JOHN H. CHAFEE

Good morning. Today, this Committee turns once again to enterprise zones. The bills on today's agenda are the latest in a long line of enterprise zone proposals. While the legislation has changed during the past 4 years of debate, the goal remains the same—the revitalization of severely depressed inner cities and rural areas.

The concept underlying enterprise zones is to encourage job-creating investment and business activity in targeted distressed areas. This would be accomplished by providing relief from Federal, State, and local taxes and regulations, while improving some local services. Together with the efforts of a local community-private sector partnership, this relief will create the environment necessary to revive rundown areas.

Enterprise zones are not intended to be a panacea for urban and rural distress. This is an experimental program with a limited number of potential zones. The purpose of this is to move ahead slowly, to get some experience, to see whether we are on the right course before we being a full-blown program with enterprise zones across the country. This innovative program would be an excellent complement to existing economic development tools, such as Community Development Block Grants, UDAG, and job-training.

The focus of today's hearings will be on the progress the States and local communities have made in laying the foundation for enterprise zones. Fourteen States have already enacted enterprise zone legislation and some have even started designating areas eligible for State and local incentives. This local response illustrates the need for quick Federal action in enacting and implementing a Federal enterprise zone program.

After HUD Secretary Pierce and Mr. Swain from the Small Business Administration testify on the Administration's bill, we will hear progress reports from a number of local government and business leaders.

Again, it is the grassroots activity and support for enterprise zones that compels us to make enactment of a Federal enterprise zone program a priority.

I am sure we will hear many valuable insights today, and I look forward to the testimony.

The CHAIRMAN. Senator Heinz.

Senator HEINZ. Mr. Chairman, I too want to commend you on holding these hearings. The subject of enterprise zones is one that many of us on the committee share a deep interest in and have a tremendous degree of enthusiasm and hope for.

I was privileged to be the author of a bill that preceded any Senate bill in this area, the Revitalization Zone Act of about 3 or 4 years ago. Then Senator Chafee and Senator Boschwitz teaming up with Congressman Kemp and Congressman Garcia in the House developed an improved Enterprise Zone bill.

I hope we can get action soon on it, but I wouldn't want anybody to think that it is going to be easy to answer all the questions on enterprise zone legislation. There are some questions we have to address as to how the existing businesses in these zones are going to fare. They don't have the kinds of taxes with which to take advantage of the various kinds of credit.

We need to be clear on what we expect to happen with respect to the people in the zone. Some people say, for example, the definition of who is employable within a zone is too restrictive. We need to be clear as to how this proposal will work, and not just in urban areas where it is very much needed, but in rural areas as well, where unemployment can run even higher, as it does in parts of my State.

I don't wish to catalog or anyone to think that such catalog of questions means that this bill can't pass. I think it can. I think these are all answerable questions. But clearly this is not a bill, no matter how much effort the administration, Congressman Garcia, Senator Chafee and others have put into it—and they have put a tremendous amount of work into this bill—that can simply be rubberstamped and sent to the floor of the Senate for action.

I do want to commend Congressman Garcia for being here. I know he has worked long and hard on this legislation. I remember a meeting that he and I had down at the White House with Secretary Pierce and others a few years ago—actually, I guess it was in the previous administration, come to think of it. There was a fellow from your district, Bob, who asked what I thought was the $64 question. He was a small businessman that you had been able to get an SBA loan guarantee for, as I recollect.

The question came up, Mr. Chairman, if these areas are not only somewhat depressed, as the South Bronx is, but not quite as safe as we would like, how are we going to address the risk element in getting people to invest there? And this fellow put it rather plainly. He said, "if we don't have some kind of assistance such as the SBA program or the EDA program that helped me," he said, "some kind of underwriting, guarantee, encouragement," he said, "I don't know why anyone would want to invest in a place where you are afraid to walk down the street with $5 in your pocket."

That still remains a challenge for us, not an insurmountable one, but nonetheless a real one.

Thank you, Mr. Chairman.

The **CHAIRMAN**. Thank you very much, Senator Heinz. I would also ask that a statement by Senator Specter, who had planned to be here this morning but will not be here, be made a part of the record.

[The statement of Senator Specter follows:]

STATEMENT OF SENATOR ARLEN SPECTER

Mr. Chairman, and Members of the Committee, I welcome the opportunity to testify on enterprise zones. I am an original cosponsor of Senator Boschwitz's bill, S. 863, and intend to introduced the Rural Enterprise Zone Act of 1983. My interest in this legislation is heightened by the fact that Pennsylvania has more economically distressed areas, as defined under the Urban Development Action Grants programs, than any other State in the country.

Over the past few months, I have been soliciting comments from various public officials, both from urban and rural areas, throughout Pennsylvania on the concept of enterprise zones. In almost every case, these community leaders have stressed the need to couple federal tax incentives provided in enterprise zone legislation with federal funding for infrastructure improvements. We all are aware of the necessary constraints on the federal budget, but perhaps expediting existing federal monies, such as priority targeting of all federal programs and services to designated areas, could work to provide such assistance without vast new outlays of revenues. Without basic improvements to the environment and public services, cities and towns will have difficulty attracting business investment.

There is also concern that 75 zones over three years is not enough. Currently, 2,000 communities are eligible for UDAG monies, a basic criteria for zone designation. At least ten percent of these should be able to receive zone designation, perhaps with an extension of the designation period to four or five years, similar to the provisions in Senator Hart's bill, S. 634. The initial costs to the Treasury in foregone taxes will be significant, estimated at $12.4 million during the first year for a zone including 10,000 new employees, but the costs should steadily decline as new businesses and new jobs generate taxable incomes and paychecks replace welfare checks.

New and expanding industries will need newly trained employees. In most areas, the workers are there, but many lack the necessary skills. I would recommend inclusion of a tax credit to businesses, similar to that proposed in legislation I have introduced, the Tax Credit for Job Training Act, providing a tax credit for contributions to job training programs. This mechanism would allow nonprofit organizations, such as schools and community associations, to transfer tax benefits accruing from their economic development efforts to private corporations. Zone sponsors could then establish training and retraining programs in coordination with the needs of businesses located in their zone. My State of Pennsylvania offers a similar tax credit under the Neighborhood Assistance Act. This program has been successful and would be a useful tool in federal enterprise zones.

I am concerned that the bills before the Committee do not provide sufficient opportunities for rural areas to receive zone designation. S. 863 does earmark one-third of the zones for rural areas, defined as areas with populations of less than 50,000. However, I fear that small towns and villages will not receive designation when in competition with more densely populated areas which have a broader range of local contributions and commitments to draw from. The problems of chronic unemployment, poverty, population loss and physical deterioration are just as pervasive in these areas. In Pennsylvania, for instance, one-third of the population resides in non-urban areas. The average unemployment rate for the State is 13.4 percent, but the rate in rural countie averages 14 percent, with some counties higher than 20 percent. I am concerned that a town of 10,000 will have little chance when competing with small cities of 40,000. If this experiment is to succeed, we must consider a mix of zones, including metropolitan, small cities and communities, and rural towns and villages. I would recommend that there be three classes of population criteria to assure that our truly rural areas are given the opportunity to participate. I would also like to see the Secretary of Agriculture granted more authority over the selection of enterprise zones located in rural areas. The Department of Agriculture has a history of successfully contributing to rural development through administration of loans and grants for business, housing, and services, and should be included in the decision-making process.

Greater emphasis should be placed on zone management capabilities. Eligible areas should be required to demonstrate the marketing and administrative abilities necessary to assure that the objectives of job creation and economic revitalization will be achieved. Good management will be essential to coordinate the various local activities to best address the zone's economic deficiencies. In addition, zone sponsors must be adept at marketing their area to businesses and investors to maximize the benefits derived from tax incentives. Without these skills, success would be unlikely and revenues wasted.

Pennsylvania has taken administrative action to establish enterprise zones within the state known as Enterprise Development Areas. The Pennsylvania program provides direct grants, financing assistance, regulatory flexibility, and priority targeting of State services. The Southern Alleghenies Regional Commission, a consortium of rural governments comprised of six counties, has applied for designation as an Enterprise Development Area. Commitments have been extracted from 42 civil divisions, with an average unemployment rate of 23.5 percent. Their contributions range from providing land and expediting zoning and building permits to increased fire and police protection and reduction of utility rates. This is an excellent example of community and regional cooperation and the Commission is convinced that designation as a State Enterprise Area will make a significant impact on this region's economic recovery. Additional Federal action to complement current State activities would greatly improve their ability to attract business and revitalize the area. At this time, I would like to submit written testimony by the Southern Alleghenies Regional Commission regarding their thoughts on federal enterprise zone legislation.

I would also like to submit a brief explanation of my rural enterprise zone legislation for the record.

Mr. Chairman, and Members of the Committee, I commend you for your leadership on this most important issue and, again, appreciate the opportunity to testify. As I mentioned, I am a strong supporter of enterprise zone legislation, but a few adjustments in pending legislation need to be made to assure success. I look forward to working with you in the future.

RURAL ENTERPRISE ZONE ACT—EXPLANATION OF PROVISIONS

General provisions.—Establishes 15 zones per year for three years designated by the Secretary of Agriculture. Zones can be nominated and managed by a local government, State government, or consortium of governments.

Eligibility.—Nominated area must be within the jurisdiction of the government or governments nominating the area; boundary must be continuous; area must be outside a standard metropolitan statistical area, entirely within an Indian reservation or otherwise determined by the Secretary as "rural".

One of the following conditions must exist: (1) Unemployment rate must be at least 125 percent; of the national average; (2) poverty rate must be at least 20 percent; (3) at least 70 percent of households in the area must have incomes below 80 percent of median income of households within the area, and (4) population of the area must have decreased by 20 percent between 1970 and 1980.

Rural Enterprise Zone Plan.—The government or governments nominating an area must submit an enterprise zone plan to the Secretary outlining commitments and contributions by private organizations, businesses, and state and local governments to encourage economic expansion, including tax and technical and management assistance. The entity nominating must guarantee the ability to manage the zone, including the ability to certify residents for tax assistance. The entity must describe the planned use of existing federal resources and how such use will enhance tax incentives provided by this bill.

Preferences in Designation.—Preference will be given to areas with plans which demonstrate the following:

Broad community support; ability of entity nominating to meet commitments, make land available, and reduce taxes; minimizes federal and state expenditures; minimizes loss of revenues, and labor-intensive. Preference will also be given to areas with high annual rates of unemployment

Preference for Federal Programs and Services.—Enterprise zones will be granted preference for federal loans, grants, and services for which they are eligible.

TAX INCENTIVES

Tax Credit for Employers.—Provides credit of 10 percent of qualified increased employment and economically disadvantaged credit union; "qualified increased employment"—excess wages paid during a taxable year over the base period wages prior to designation as zone; "economically disadvantages credit"—wages paid to certain individuals, i.e., those who receive or are qualified for general assistance, or are eligible work incentive employees.

Investment Tax Credits.—Provides a 5 percent increase in the investment tax credit for personal property (for a maximum total of 15 percent) and a 10 percent increase for new construction (for a maximum total of 20 percent).

Job Training.—Similar provisions to those contained in S. 481, the Tax Credit for Job Training Act, providing tax credits to corporations which contribute to community organizations for the purposes of job training. The credit would be 10 percent.

Expensing.—Small business (as defined by the Small Business Administration, i.e., less than 500 employees and less than $9—$12 million total annual sales) would be given the option of expensing rather than depreciating the costs of conducting business.

Capital gains.—For the purposes of capital gains tax, corporations will be taxed at a rate of 28 percent on the difference between net capital gain for the taxable year and the qualified rural enterprise zone capital gain.

"Qualified rural enterprise zone capital gain".—Gain attributable to sale or exchange of personal or real property or interest in a corporation which is predominantly in a zone and actively engaged in conducting trade in the zone.

Taxpayers other than Corporations.—The section in the Internal Revenue Code relating to deductions for capital gains is amended to allow a deduction from gross income in any year such taxpayer has a capital gain an amount equal to: 100 percent of the lesser of the net capital gain or the qualified rural enterprise zone capital gain (as defined previously) plus 60 percent of the difference (if any) between the net capital gain and the capital gain taken above. Gain attributed to "qualified rural enterprise zone capital gain" is exempt from the minimum tax.

Industrial Development Bonds.—Limitations on property financed with tax-exempt bonds will not apply to rural enterprise zones, nor shall the termination of the small issue exemption.

TESTIMONY BY SOUTHERN ALLEGHENIES PLANNING AND DEVELOPMENT COMMISSION

We as a Commission are pleased to submit the following testimony for the record to the Senate Finance Committee. We applaud the Committee for holding hearings regarding enterprise zone legislation since we, as a Commission, believe this legislation could initiate a bold and successful experiment toward the economic development of distressed areas in our country.

The Southern Alleghenies region is comprised of six counties in southcentral Pennsylvania. Located in the heart of the Allegheny Mountains, the region has a population of 515,000. Most of the population in the three counties of Blair, Cambria, and Somerset, while the remaining counties -- Bedford, Fulton, and Huntingdon -- are sparsely populated and rural in nature.

Despite its proud history, its physical endowment, and its human resources, the Southern Alleghenies region suffers from severe economic problems today, the result both of the age and the nature of its industrial base. The economy of the region has been dependent on the same major industries for more than 100 years. The heavy manufacturing industries primarily steel production, mining, transportation, and agriculture have, in many cases, been using the same facilities for decades. In today's increasingly competitive environment, these industries are losing ground to more modernized foreign industries.

The deterioration of the region's economy has fostered an appalling level of unemployment, low levels of income, and increasing numbers on public assistance. For more than 10 years running, the unemployment rate in the Southern Alleghenies region has outstripped the unemployment rates for both the State of Pennsylvania and the nation as a whole. At present, the rate approaches in excess of 23 percent, with some areas in the region over with 30 percent of their residents unemployed. Youth unemployment is a particular problem. Dependence on public assistance is also now a chronic problem.

In summary, the region's problems seem to be almost insurmountable. A mature industrial base, whose facilities are generally outmoded; a stagnating economy and the steady decline in job opportunities leading to chronic unemployment make the economic resurgence an urgent necessity. But it will not entirely come from the existing industrial base. We recognize that to achieve economic recovery, several economic development strategies must be employed; we need to:

- Revitalize the existing industrial base, to the extent possible;
- Add new industrial activities to the existing base;
- Diversify economic activity, with special attention to the service and light manufacturing sectors;
- Encourage new, small businesses -- as a source of jobs, technological innovations, and needed products.

The Southern Alleghenies region has made a start at implementing these economic development strategies, but prospects for eventual success are limited. While the region has the commitment, the physical requirements, and the human resources to make a substantial effort, the pace of increasing problems outruns the ability to forge solutions.

We believe that the region needs the additional help that only the state and federal governments can provide by means of enterprise zone legislation. As an enterprise zone, the Southern Alleghenies region would have: a catalyst for a broad range of related economic development activities; a means of ensuring regional cooperation and participation in the zone's activities; and -- most importantly -- a way of overcoming barriers and disincentives to business expansion, job creation, and economic development in general.

We have a number of concerns with many of the proposed approaches in current legislation before Congress, including the Administration's proposal. Based upon our experience with economic development, coupled with close observation of what other nations, states, and communities are doing for economic development, we outline the following short-comings to proposed legislation.

1. Designation of Potential Enterprise Zones

   o Currently, there is a lack of explicit mention in the legislation of consortia of governments as zone sponsors. Especially in the case of rural areas, these organizations could be instrumental in aiding rural areas in the implementation of the enterprise zone concept.

   o The criteria for selection of an area as an enterprise zone focuses exclusively on a potential zone's ability to provide tax and regulatory relief, public services, and community support. We believe the following additional criteria should also be closely considered when selecting an area as an enterprise zone:

1. The potential of the zone for job creation, particularly for disadvantaged workers, should be considered..

2. The evidence of commitment by zone businessses willing to conduct operations in zones should be examined.

3. The capabilities of zone sponsors for management and for assuring performance on commitments in zones should be considered.

4. The ability of the zone sponsor to document the return on "public investment" in the potential zone should also be examined.

- There also is a need for specific language to prevent distorting the selection process or eliminating worthy candidates for zone selection.

- There are limits in present bills on population size and geographical area, rather than focusing upon limits on tax expenditures by selective and judicious use of incentives. This should be corrected to more judiciously assure the success of the program.

- Legislation should guard against competition between housing rehabilitation and job generating economic development as the focus on enterprise zone incentives.

- Considerable discretionary authority by HUD officials in setting criteria and selecting areas for zone designation should be tempered by obligatory consultation with the Secretaries and Commerce and Agriculture.

2. Management

- There is a lack of focus on and measurement on return on "public investment" in zones. There should be increased emphasis in this area to ensure cost effectiveness of enterprise zones.

- There is a failure to require proforma analysis of zone commitments, to ensure performance based use of zone incentives.

- There is no explicit consideration or mention of "target areas" within zones.

- There is unclear authorization of flexibility in contractural commitments in zones, as would be required for individual firms and for changing economic conditions.

3. Incentives

- In the current legislation, there is lack of adequate tools for capital formation, particularly for small, but growing firms.

- There is lack of attention to cash flow enhancement for zone businesses.

- There is a failure to encourage firms to initiate regulatory relief and administrative streamlining measures, relying instead on HUD or local officials to identify such barriers.

4. Other Issues

- The necessity to experiment with a range of zone types and approaches. We are especially concerned that some type of set-aside for rural areas be included in any final drafting of the legislation.

- The need to monitor and evaluate zone operations, to ensure performance and to provide evidence for improvement and expansion of the zone program.

- The lack of absolute commitment to other, complementary federal programs used in conjunction with enterprise zone commitments to ensure maximum success is achieved in zone efforts.

The Commission further wishes to emphasize the fact that legislation should be tailored to allow an enterprise zone approach with a regional prospective in order to provide the management assistance needed to connect areawide activities and generate the greatest possible local and regional impact.

As an example of how rural areas may indeed successfully participate in enterprise zones, the following activities have recently occurred in the continual development and operation of the Southern Alleghenies Commission's Enterprise Zone.

At its Mid-Term Conference held March 28-29, 1983, the Commission formally agreed to the target areas within the Southern Alleghenies Enterprise Zone. These will involve 42 minor civil divisions plus the two cities of the third class. In each target area, the MCD's, plus the development corporations, have committed a variety of local incentives geared toward creating an enriched and competitive business environment to encourage the expansion and retention of existing small businesses, the creation of new small businesses, and the employment of disadvantaged individuals.

Formal resolutions from these municipalities have been forwarded to the Commission during the second quarter of this year, cementing their solid commitment toward job creation and job retention. Incentives offered by formal resolution include, but are not limited to:

1. Free developable land or available land at reduced market values.
2. Tax breaks through utilization of the State's LERTA program.
3. Increased police and fire protection.
4. Maintenance of access roads.
5. Expedition of zoning permits.
6. Customized training programs.
7. Technical assistance to businesses.
8. Expedition of building permits.
9. Reduction of sewer, water, and gas rates whenever possible.
10. Improved community services.
11. Writedown on industrial buildings.

Commission sponsored incentives (in addition to those pledged locally to the Commission) will be made available in the target areas. These include assistance in quality circles, targeted loan programs, targeted job training, and tax credits for employers hiring disadvantaged workers.

Additionally, the Commission has developed a comprehensive zone marketing program to promote regional, state-wide, and national awareness regarding the local commitments available to prospective businesses in the Southern Alleghenies Enterprise Zone.

Until there is passage of federal zone legislation, Southern Alleghenies Commission staff will work through Pennsylvania's Enterprise Development Area initiative. Southern Alleghenies staff is currently assisting municipalities in submission of applications for designation as Enterprise Development Areas. This may take the form of a six-county application including the rural municipalities wishing to be designated and separate applications for the city areas.

The **Chairman**. Congressman Garcia, we are pleased to have you here as one of the pioneers in this area. We appreciate anything you may want to say.

STATEMENT OF HON. ROBERT GARCIA, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW YORK

Mr. **Garcia**. Thank you. I would like to thank you, Senator Dole, Senator Chafee, Senator Heinz. And if I may, I have a brief statement. I believe it will take all of 7½ minutes. I would like to read it. Then I would be delighted to respond to any questions.

I want to thank all of you for the opportunity to testify today on a topic which I think we have all heard a great deal about. I believe the debate on the enterprise zones has probably lasted longer than some urban programs.

During the last 3 years, we have seen many proposals for an urban enterprise program, all seemingly missing one or more key components. However, the committee has before it some fascinating ideas for stimulating new development. I can only encourage you to review each closely with the underlying intent to stimulate new business startups in the inner city, and in turn, create new jobs for residents of these areas.

The current situation in most American cities is very grave, characterized not only by record numbers of small business bankruptcies and the highest unemployment rate in 50 years, but also by human suffering, helplessness, and deprivation. The reduction in central city economic activity has brought about a corresponding deterioration of employment opportunities for the people living in those areas. Minorities, low-income persons, and female-headed households have been particularly hard hit since they are increasingly concentrated in such communities, the very communities which will lag behind the Nation as it struggles to economically revise itself.

I truly believe that calculated and reasoned Government intervention is necessary to minimize the effects and if possible, eliminate the causes of harmful distortions in economic behavior which have, in so many ways, caused the decline of American cities. In devising the mechanism for such intervention, we must be as precise as possible in our thinking about what the Government can do to help rebuild these troubled areas.

What I hope to accomplish through the enterprise-zone proposal is the rebuilding of community roots. I have worked to devise not simply a program for urban industrial parks, but if you will, a program to resurrect the economic strength of urban neighborhoods. The objective is to offer jobs enabling workers to bring home their wages, which will be spent purchasing goods and services from other neighborhood businesses. I am fully aware that rebuilding a community with a self-perpetuating economy and the strengthened local economic base is a huge task.

And if I may just divert from the text for 1 quick second, I like to tell the story, Senator, that when I was a young boy growing up in the South Bronx, my aunt lived on 139th Street; 139th was pretty much a tenement area, residential but for the most part tenements. On the other side of 138th Street and Brook Avenue in the

South Bronx we had the large industrial corporations, manufacturing facilities, if I may.

My aunt—in those days, I guess the wages may have been $25, $30 a week, 65 cents, 75 cents an hour. But the interesting thing about my aunt, who lived at 595 East 139th Street, she worked in this factory for about, I guess, 18 years. In those 18 years she walked to and from work. But more important was that on 138th Street a few blocks east of the factory was a large commercial shopping center, small storekeepers, groceries and men's and women's shops, linen shops.

Anyway, the point is that my aunt who lived there, worked there. And when it came to Fridays and Saturdays after she received her pay, she did her shopping there. So those $25 or $30 that were earned in those days were recycled within that same community because those moneys went to the merchants within those communities.

I make that point because when I first got involved with enterprise zones, that is what I envisioned as what the enterprise zone would be, a total and complete community.

As your committee proceeds, I would encourage you to explore two very important areas which I feel the administration bill is lacking. The first deals with the need for startup capital for small and minority businesses.

Both Senator Boschwitz's proposal and that of Senator Hart, coupled with Congressman Parren Mitchell, call for the establishment of an expensing provision to encourage investors outside the enterprise zones to purchase stock in enterprise zone small businesses. I am very supportive of this idea, though I understand that the committee may have some technical problems with it. However, we could at least establish this provision on a trial basis, subject to review by this committee.

Second, the administration's proposal is lacking in any real housing effort. While the additional investment tax credit contained in the bill is useful, may I suggest, and it is just a suggestion, that the committee also explore other methods to increase the opportunity for housing within an enterprise zone. I have presented several ideas to various organizations here in Washington, including the National Association of Home Builders.

What seems to be the most workable at this time is an acceleration of the depreciation of multifamily housing buildings and an expansion of the amount of each unit which can be depreciated. In order to receive these additional benefits, the developer would need to provide some minimum level of low- and moderate-income housing units.

In addition, I would urge this committee to maintain the employee tax credit, which was dropped during the last year's markup. This credit is not, as some have called it, combat zone pay, but rather a real attempt to increase the disposable income of those who take jobs with businesses in the zone.

Other improvements include some form of pass-through mechanism for Puerto Rico and the Virgin Islands. I guess, as the only Puerto Rican today sitting in the Congress of the United States of Puerto Rican ancestry, elected from the State of New York, obviously I am called upon many, many times by Puerto Rico to help in whatever way I can. I would just urge this pass-through mechanism for Puerto Rico and the Virgin Islands, who may not be able to benefit from the zone proposals because of their unique tax systems.

While reviewing these proposals, we must keep in mind that the enterprise zone program is not a substitute for other urban programs. In fact, the more that other urban programs are reduced, the less the likelihood of any success with the enterprise zone program.

And in closing, Mr. Chairman and members of the committee, in 1967 a colleague of yours here, the late Senator Bob Kennedy—and it is interesting that 15 years later it is so appropriate—he said:

> "The Nation faces many problems. Some are outside our borders. Some are almost beyond our comprehension. The awful potential of nuclear weapons, the technical complexities of air and water pollution. The meaning of learning in the age of computers. But of all our problems, none is more immediate, none is more pressing, none is more omnipresent than the crisis of unemployment in every major city in the Nation."

That was over 15 years ago. And I would hope that in the year 1983, Mr. Chairman, that we would be able to do something about it and I thank you very much.

The CHAIRMAN. Senator Heinz.

Senator HEINZ. No questions, Mr. Chairman. I am just delighted to see Bob Garcia here. Thank you.

The CHAIRMAN. Senator Chafee.

Senator CHAFEE. Thank you, Mr. Chairman.

We are going to have testimony from Mr. Cantor later on of the AFL–CIO, and we are familiar with his testimony from prior years. He is going to be opposed to this legislation. He is going to say that this encourages the flight of industry or the transferal of industry and that the overall effect, thus, is not beneficial.

What is your answer to that, Mr. Garcia?

Mr. GARCIA. Well first of all, before I respond to that, Senator Chafee, I would just like to say to the labor movement that there is probably nobody in the House that has a better labor voting record than Bob Garcia in my 18 years of voting as a New York State Senator and here in the last four terms, the last four Congresses.

My response to that is that the experience has not been the question of relocation. The fact of the matter is the AFL–CIO feels that other programs, for example Operation Bootstrap in Puerto Rico, was an operation in which companies just picked up and moved to Puerto Rico and left where they were here on the mainland.

The experience with Operation Bootstrap, that experience was a very positive one for Puerto Rico in that it took it out of an agricultural society, a society which was really in dire straits, to becoming a very middle class society, and if I may, to a society where Republicans have as good a chance of winning the legislative seats as Democrats. And I think that that is indicative of the type of society we have in Puerto Rico today.

My response to them also is that under these provisions and with the role that I hope the local governments play, from the city halls to the State capitals and to the community planning boards at the local level, that we will be monitoring, and that the tax incentives will be monitored very closely because what we are really aiming for is the unemployed. We are aiming for the people who live in those areas, not people coming over in my case from New Jersey or Pennsylvania or any place that they feel that this will happen.

I am very positive that the enterprise zone is really worth the try, and I think sometimes, even amongst those of us who get along very well, we can lose our perspective. And I think that in this particular case, the AFL–CIO should at least give us the opportunity to try it in America's inner cities.

Let me make one other point if I may, Mr. Chafee. When we had demonstrations in midtown New York in the building trades where there were blacks and Hispanics and it came close to rioting, most of those people came out of districts like mine. The fact of the matter is, the reasons why those demonstrations were taking place is because we can't get jobs in those unions. There are no available jobs there. Yet those buildings are being built in New York. The least that the AFL–CIO could let us try to do is to create an environment in those areas in which there are, for the most part poor people, made up in today's society of blacks and Hispanics.

So it seems to me that they should at least give us a try and see where we go because we have to put people back to work.

Senator CHAFEE. Does your legislation have the same limitations as this, the 25 plus the one-third to rural?

Mr. GARCIA. Yes. I believe at this particular moment that is the way the legislation is written.

Senator Chafee. Thank you very much, Bob.

The CHAIRMAN. I just want to thank you again, Mr. Garcia, for reenforcing your support of what I think is a good idea. That doesn't mean we don't have problems with it. We have a lot of questions. Hopefully you can work on Steve Koplan. He is in here now. Maybe you can catch him on the way out. There he is.

Mr. GARCIA. We have had many discussions, Senator.

The CHAIRMAN. Well, he is a good man. I think he is coming around a little bit. Not much, though. I hope you can do a little better on the House side. I don't think they have moved very far in the last 3 years. We are going to really seriously try to make it happen over here this year and we understand the need to get it moving over there.

So we appreciate it and we will be calling on you.

Mr. GARCIA. Thank you very much.

Senator CHAFEE. Where do things stand? What is the travel in the House, as you expect it?

Mr. GARCIA. Well, at the present time I am happy to report that we have four or five members on the Democratic side of the Ways and Means Committee who are very supportive. Four of them have their name on the legislation. I have had conversations with my colleague from New York, Congressman Rangel, who is third or fourth ranking on the committee, and we are presently in a situation where negotiations are underway to try to get some hearings over in the House side as soon as possible.

Senator CHAFEE. Is Ways and Means the only committee of jurisdiction?

Mr. GARCIA. Well, we have some jurisdiction in my committee, Banking and Finance, because of the HUD aspects of it, but the committee that really has the jurisdiction, Senatora Chafee, is Ways and Means.

[The prepared statement of Hon. Robert Garcia follows:]

PREPARED STATEMENT OF HON. ROBERT GARCIA, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW YORK

CHAIRMAN DOLE, SENATOR CHAFEE, MEMBERS OF THE SENATE FINANCE COMMITTEE, THANK YOU FOR THE OPPORTUNITY TO TESTIFY TODAY ON A TOPIC ABOUT WHICH WE ALL HAVE HEARD A GREAT DEAL. INDEED, WE SEEM TO HAVE DEBATED ENTERPRISE ZONES LONGER THAN SOME URBAN PROGRAMS EVEN LAST ON THE BOOKS.

DURING THE LAST THREE YEARS WE HAVE SEEN MANY PROPOSALS FOR AN ENTERPRISE ZONE PROGRAM, ALL SEEMINGLY MISSING ONE OR MORE KEY COMPONENTS. HOWEVER, THE COMMITTEE HAS BEFORE IT SOME FASCINATING IDEAS FOR STIMULATING NEW DEVELOPMENT. I CAN ONLY ENCOURAGE YOU TO REVIEW EACH CLOSELY WITH THE UNDERLYING INTENT TO STIMULATE NEW BUSINESS START-UPS IN THE INNER CITY AND IN TURN CREATE NEW JOBS FOR RESIDENTS OF THESE AREAS.

THE CURRENT SITUATION IN MOST AMERICAN CITIES IS VERY GRAVE, CHARACTERIZED NOT ONLY BY RECORD NUMBERS OF SMALL BUSINESS BANKRUPTCIES AND THE HIGHEST UNEMPLOYMENT RATE IN FIFTY YEARS, BUT ALSO BY HUMAN SUFFERING, HELPLESSNESS AND DEPRIVATION. THE REDUCTION IN CENTRAL CITY ECONOMIC ACTIVITY HAS BROUGHT ABOUT A CORREPSONDING DETERIORATION OF EMPLOYMENT OPPORTUNITIES FOR THE PEOPLE LIVING IN THOSE AREAS. MINORITIES, LOW-INCOME PERSONS AND FEMALE HEADED HOUSEHOLDS HAVE BEEN PARTICULARLY HARD HIT SINCE THEY ARE INCREASINGLY CONCENTRATED IN SUCH COMMUNITIES ---- THE VERY COMMUNITIES WHICH WILL LAG BEHIND THE NATION AS IT STRUGGLES TO ECONOMICALLY REVIVE ITSELF.

I TRULY BELIEVE THAT CALCULATED AND REASONED GOVERNMENTAL INTERVENTION IS NECESSARY TO MINIMIZE THE EFFECTS AND IF POSSIBLE ELIMINATE THE CAUSES OF HARMFUL DISTORTIONS IN ECONOMIC BEHAVIOR WHICH HAVE IN SO MANY WAYS CAUSED THE DECLINE OF AMERICAN CITIES. IN DEVISING THE MECHANISMS FOR SUCH INTERVENTION WE MUST BE AS PRECISE AS POSSIBLE IN OUR THINKING ABOUT WHAT THE GOVERNMENT CAN DO TO HELP REBUILD THESE TROUBLED AREAS.

WHAT I HOPE TO ACCOMPLISH THROUGH THE ENTERPRISE ZONE PROPOSAL IS THE REBUILDING OF COMMUNITY ROOTS. I HAVE WORKED TO DEVISE NOT SIMPLY A PROGRAM FOR URBAN INDUSTRIAL PARKS, BUT IF YOU WILL, A PROGRAM TO RESURRECT THE ECONOMIC STRENGTH OF URBAN NEIGHBORHOODS. THE OBJECTIVE IS TO OFFER JOBS ENABLING WORKERS TO BRING HOME THEIR WAGES WHICH WILL BE SPENT PURCHASING GOODS AND SERVICES FROM OTHER NEIGHBORHOOD BUSINESSES. I AM FULLY AWARE THAT REBUILDING A COMMUNITY WITH A SELF-PERPETUATING ECONOMY AND A STRENGTHENED LOCAL ECONOMIC BASE IS A HUGE TASK, BUT NOT ONE WHICH IS IMPOSSIBLE OR WHICH WE SHOULD SHY AWAY FROM.

AS THIS COMMITTEE PROCEEDS, I WOULD ENCOURAGE YOU TO EXPLORE TWO VERY IMPORTANT AREAS WHICH I FEEL THE ADMINISTRATION'S BILL IS LACKING. THE FIRST DEALS WITH THE NEED FOR START-UP CAPITAL FOR SMALL AND MINORITY BUSINESSES. BOTH SENATOR BOSCHWITZ'S PROPOSAL AND THAT OF SENATOR HART AND CONGRESSMAN PARREN MITCHELL CALL FOR THE ESTABLISHMENT OF AN "EXPENSING" PROVISION TO ENCOURAGE INVESTORS OUTSIDE THE ENTERPRISE ZONE

TO PURCHASE STOCK IN ENTERPRISE ZONE SMALL BUSINESSES. I AM VERY SUPPORTIVE OF THIS IDEA THOUGH I UNDERSTAND THAT THE COMMITTEE MAY HAVE SOME TECHNICAL PROBLEMS. HOWEVER, WE COULD AT LEAST ESTABLISH THIS PROVISION ON A TRIAL BASIS SUBJECT TO REVIEW BY THIS COMMITTEE.

SECONDLY, THE ADMINISTRATION'S PROPOSAL IS LACKING IN ANY REAL HOUSING EFFORT. WHILE THE ADDITIONAL INVESTMENT TAX CREDIT CONTAINED IN THE BILL IS USEFUL, MAY I SUGGEST THAT THE COMMITTEE ALSO EXPLORE OTHER METHODS TO INCREASE THE OPPORTUNITY FOR HOUSING IN AN ENTERPRISE ZONE. I HAVE PRESENTED SEVERAL IDEAS TO VARIOUS ORGANIZATIONS HERE IN WASHINGTON INCLUDING THE NATIONAL ASSOCIATION OF HOME BUILDERS. WHAT SEEMS TO BE THE MOST WORKABLE AT THIS TIME, IS AN ACCLERATION OF THE DEPRECIATION OF MULTI-FAMILY HOUSING BUILDINGS AND AN EXPANSION OF THE AMOUNT OF EACH UNIT WHICH CAN BE DEPRECIATED. IN ORDER TO RECEIVE THESE ADDITIONAL BENEFITS, THE DEVELOPER WOULD NEED TO PROVIDE SOME MINIMUM LEVEL OF LOW AND MODERATE INCOME UNITS.

IN ADDITION, I WOULD URGE THIS COMMITTEE TO MAINTAIN THE EMPLOYEE TAX CREDIT WHICH WAS DROPPED DURING LAST YEAR'S MARK-UP. THIS CREDIT IS NOT, AS SOME WOULD CALL IT, "COMBAT ZONE PAY", BUT RATHER A REAL ATTEMPT TO INCREASE THE DISPOSABLE INCOME OF THOSE WHO TAKE JOBS WITH BUSINESSES IN THE ZONE.

OTHER IMPROVEMENTS INCLUDE SOME FORM OF PASS-THROUGH MECHANISM FOR PUERTO RICO AND THE VIRGIN ISLANDS WHICH MAY NOT BE ABLE TO BENEFIT FROM THE ZONE PROPOSAL BECAUSE OF THEIR UNIQUE TAX SYSTEMS.

WHILE REVIEWING THESE PROPOSALS, WE MUST KEEP IN MIND THAT THE ENTERPRISE ZONE PROGRAM IS NOT A SUBSTITUTE FOR OTHER URBAN PROGRAMS. IN FACT, THE MORE OTHER URBAN PROGRAMS ARE REDUCED, THE LESS THE LIKELIHOOD OF ANY SUCCESS WITH THE ENTERPRISE ZONE PROGRAM.

IN CLOSING I WOULD LIKE TO ONCE AGAIN REVIEW THE WORDS OF ROBERT KENNEDY WHO SUBMITTED SIMILIAR TAX LEGISLATION TO ENCOURAGE INVESTMENT IN URBAN AREAS IN 1976.

SENATOR KENNEDY STATED THAT "THIS NATION FACES MANY PROBLEMS. SOME ARE OUTSIDE OUR BORDERS, SOME ARE ALMOST BEYOND OUR COMPREHENSION. THE AWFUL POTENTIAL OF NUCLEAR WEAPONS; THE TECHNICAL COMPLEXITIES OF AIR AND WATER POLLUTION, THE MEANING OF LEARNING IN THE AGE OF COMPUTERS. BUT OF ALL OUR PROBLEMS, NONE IS MORE IMMEDIATE, NONE IS MORE PRESSING, NONE IS MORE OMNIPRESENT THAN THE CRISIS OF UNEMPLOYMENT IN EVERY MAJOR CITY IN THE NATION."

IT HAS BEEN ALMOST 15 YEARS SINCE ROBERT KENNEDY SPOKE THOSE WORDS BEFORE THE U.S. SENATE. I WOULD HOPE THAT 15 YEARS FROM NOW, WE WILL BE ABLE TO LOOK BACK AT HIS WORDS AND KNOW THAT WE LEFT NO AVENUE UNEXPLORED, NO URBAN PROGRAM UNTRIED AND NO UNEMPLOYED INNER CITY RESIDENT WITHOUT HOPE.

THANK YOU.

Senator Chafee. Good. Thank you very much.

The Chairman. Well, we are honored to have pretty good timing, Secretary Pierce and I assume, other officials of HUD. I have learned to defer to members of the Cabinet. Whenever they arrive, we put them right on.

Sam, we are happy to have you here today.

I would say at the outset your entire statement will be made a part of the record. We are pleased to have you before the committee. We know of your strong support of enterprise zone legislation. We have just indicated to Congressman Garcia, who has been very helpful on the House side, that we are serious about it. We know the administration is serious about it, and Senator Chafee has indicated he is going to do all he can to move it quickly in the Senate.

STATEMENT OF HON. SAMUEL R. PIERCE, JR., SECRETARY, DEPARTMENT OF HOUSING AND URBAN AFFAIRS

Secretary Pierce. Mr. Chairman, I am pleased to appear here this morning to testify on behalf of the Enterprise Zone Employment and Development Act of 1983, S. 863. I am encouraged by the bipartisan support of so many Senators for this bill. I welcome the early scheduling of these hearings as evidence that the Senate views the need for establishing and implementing this program with the same urgency that the administration and numerous States and cities do.

When a similar bill cleared this committee last year, enterprise zones in the United States were regarded as relatively unknown and experimental. Today, however, well over a dozen States are implementing their own enterprise zone programs, and roughly 15 States have legislation pending.

Thus, the enterprise zone concept is increasingly being tried as a method for stimulating private sector employment and economic growth in place of despair and decline.

This progressive State activity will continue without waiting for the Congress to act, but it needs to be enhanced by the Federal tax and regulatory relief which S. 863 will bring.

The Nation is on the road to economic recovery, thanks in large part to the economic directions this administration has charted with the bipartisan support of the Congress. Passage of the Emergency Jobs bill, the Job Training Partnership Act and tax relief legislation have been important steps. But to continue our economic progress, we must generate permanent jobs, especially for long-term unemployed and disadvantaged workers.

Economic recovery and the creation of jobs call for action and leadership at all levels of government. They require a broad-based constructive partnership among Federal, State and local governments and private industry.

We are continuing assistance for economic development through such programs as UDAG and CDBG, and we must augment them with fresh approaches to enhance the local business climate. This is why the President has proposed reintroduction of the Enterprise Zone bill this year. This bill offers a new approach to revive areas where the private sector is dormant.

Its purpose is twofold: To create jobs in depressed areas, particularly jobs for disadvantaged workers and long-term unemployed individuals, and to redevelop and revitalize the distressed areas themselves.

The concept underlying enterprise zones is the creation of an environment conducive to economic revitalization and job creation in economically depressed areas. It provides relief from taxes, regulations and other governmental burdens such as permit and licensing fees and procedures. It promotes improved municipal services and infrastructure. It directly involves private entities, organizations, neighborhood associations and citizen groups in the revitalization of their communities.

It does all this by encouraging local and State governments to actively and creatively work together as partners with the private and community sectors.

The Enterprise Zone bill contains several important additions which reflect the combined wisdom of the growing coalition supporting this idea. It benefits greatly from the ideas put forth by the small business community, State and local officials, labor organizations, and the many Members of Congress who have studied and debated our earlier legislation.

These changes include a rural set-aside, a reduction in the zone minimum population requirement for jurisdictions with populations of less than 50,000, joint city-State certification of eligibility, exemption of enterprise zone designation but not activities following designation from NEPA and related laws, preservation of potential eligibility for tax credit in State-designated zones that are subsequently federally designated, and an evaluation provision.

Members of this committee and others have helped us to enhance the participation of rural areas in this initiative. At least one-third of the up to 75 zones to be designated during the first 3 years must be in cities of 50,000 or less and located in rural areas. In addition, we have lowered the minimum population requirement for such zones from 2,500 to 1,000.

Once an area has been designated, after the competitive process, to be a Federal enterprise zone, a number of incentives become available in the form of tax and regulatory relief. The incentives are designed to create a new economic potential within the zones and to encourage the hiring and training of disadvantaged workers and the expansion of employment opportunities.

The Federal tax incentives which apply within the zones are described in detail in the legislation. They include tax credits for employers and employees, particularly disadvantaged workers. There are incentives for capital investment and for starting and building new businesses or expanding existing ones, including additional investment tax credits and exemption from the capital gains tax for qualified businesses within a zone. The most comprehensive and dramatic program of Federal tax relief ever attempted will be available within these zones.

On the regulatory side, State and local governments which receive Federal enterprise zone designation will be authorized jointly to petition for relief in their approved zones from any Federal regulation not specifically required by statute. Federal regulatory bodies will be authorized to weigh these requests under congressionally mandated standards and to relax regulations when it is in the public interest to do so, given the goals of the enterprise zone program.

This special authority would expressly not apply to any regulations designed to protect any person or group against discrimination because of race, color, religion, sex, marital status, national origin, age or handicap. Nor would it apply to any regulation affecting public safety or health, including environmental health.

The minimum wage law, for example, would not be included in the waiver authority because it is specifically set by statute at $3.35 an hour. OSHA and air quality standards also would not be subject to request for relaxation or waiver.

There are, however, a myriad of regulations imposed by the Small Business Administration, the Internal Revenue Service, HUD, Commerce, and others which, if waived or relaxed, could enhance the success of enterprise zone entrepreneurs. I expect many helpful and informative lessons will be learned from intelligent application of this provision.

Because the proposed bill seeks to remove Government burdens and increase State and local flexibility rather than providing Government subsidies, it requires no direct Federal appropriation. In fact, increased business activity and job creation may actually, in the long run, provide increased revenues and cut costs by reducing the number of persons receiving unemployment and other support, not to mention providing people the dignity and satisfaction of having a job and enhancing the local property tax base.

The Treasury Department estimates that the cost of the enterprise zone program in fiscal year 1984 would be $87 million since the tax incentives would affect taxable years beginning after January 1, 1984. The course in terms of foregone revenues in fiscal year 1985 have been calculated at $400 million, and the total cost of the program would increase commensurately in future years as the number of zones and the pace of activity increases.

These estimates do not reflect the offsetting secondary and tertiary benefits which will result, such as a reduction of welfare and unemployment costs, new revenues, enhanced local tax bases, and other economic ripple effects.

In my view, the enterprise zone proposal constitutes creative federalism at its best. It encourages city-State cooperation in addressing the problems of distressed areas as a prerequisite to possible Federal assistance. It encourages those at the grassroots level to develop strategies tailored to local conditions and opportunities aimed at physical revitalization and job creation.

Development of this city-State cooperative strategy might include such elements as assessing the business climate assets and weaknesses within a locality, providing an appropriate mix of incentives to attract business investment, examining means to improve the delivery of municipal services and strengthened infrastructure, such as sewers and roads, giving neighborhood-based groups a stake in the development and implementation of the zone, and forging working partnerships with businessmen to harness private sector commitments to economic expansion and job creation activities.

The role we are asking cities and States to play is not a new one. In recent years, many cities and States throughout this Nation have taken the initiative to meet local and statewide economic development needs. A variety of incentives have been developed which parallel the basic thrust of this legislation.

Sixteen States have already enacted enterprise zone legislation. Five so far this year and 15 additional States have legislation pending. These States and their local governments have displayed considerable creativity in their free-standing enterprise zone efforts. They also have provided a wide variety of incentives in their zone legislation.

Connecticut legislation provides venture capital loans, corporate income tax credits, sales tax exemption, employment training vouchers of $1,000 for each manufacturing job. Florida provides loans and grants to the Community Development Corporation in State enterprise zones. Kentucky has a vehicle for providing residents with equity interest in a zone through neighborhood enterprise associations, and allows exemptions from certain sales and use taxes.

Within some 400 potential zones, Louisiana exempts purchase of plant and equipment from State income, sales, and franchise taxes. Maryland offers loan guarantees from a venture capital guarantee fund. Ohio provides sales tax exemption and allows property tax abatement. I am submitting for the record a summary of State enterprise zone legislative activity.

To encourage these efforts, the Enterprise Zone Employment and Development Act of 1983 includes a useful new provision, as suggested last year by Senator Durenberger. Potential eligibility is preserved once zones are federally designated, for Federal enterprise zone employment tax credits for businesses that hire qualified workers after a zone receives State enterprise zone designation but before Federal designation.

Since economic activity is weak or nonexistent in potential enterprise zone areas, the cost of State and local tax relief could be modest. If the program is successful in stimulating new economic activity there, tax relief costs could be substantially offset through reduced expenditures due to the employment of individuals formerly receiving Government assistance and increased real property and business tax collection which scarcely existed before.

I should also note that States and communities can use CDBG and UDAG and revenue sharing funds as part of their package of commitments.

Concern has been expressed about a great problem faced by entrepreneurs attempting to start small businesses, namely, obtaining necessary startup capital. The chief reason small investors start and invest in a new business is to obtain the long-term profits they expect from the enterprise.

The tax reductions and other elements of the enterprise zone program will increase these expected long-term profits. Consequently, the program should result in an increase in the private savings available for front-end investment in small businesses in enterprise zones.

The carryover and the carryback of unused enterprise zone credits will allow small businesses which are successful to receive eventually the benefit of the zone incentives. The abatement of tariffs and import duties through the designation of foreign trade zones in enterprise zones will also help small businesses, since these taxes are again borne regardless of the profitability of the firm.

All small entrepreneurs start businesses expecting to make a profit at least some time within a 20-year period, which is the time for which Federal enterprise zone incentives may last. Tax relief will increase this expected profit and therefore should induce more small businesses to start in enterprise zones and provide a more attractive investment.

These elements will increase the likelihood of profits and cash flow of these businesses, and will also induce larger financial institutions to lend more money more freely to enterprise zone businesses. Moreover, since industrial development bonds will continue to be available for small businesses within enterprise zones, they in effect would eliminate taxation on the interest received by a lender to a small zone business. This would increase the return to the lender on such loans and therefore should increase the availability of such loans.

The inclusion of a so-called expensing provision which some people have suggested would not be an effective or a targeted means of providing front-end capital for small businesses. Most expensing provisions would allow the deduction of all or a portion of the amount of an investment in a zone business from gross income in computing tax liability.

Unfortunately, expensing could introduce an extraordinary opportunity for waste and abuse because funds generated through expensing could be used for any purpose, including those which do not result in any job or redevelopment activity. In fact, in general, the most beneficial use of funds generated through expensing is to purchase and hold inventory, warehouse goods or assets subject to appreciation.

The tax incentives offered in S. 863, on the other hand, cannot be used to support the purchase of idle assets, but must be used to improve plant and equipment or to hire and train workers.

Should an expensing provision be adopted, it could be utilized to spawn scores of storefront operations through which sales actually consummated outside the zone are supported by warehouses inside the zone, creating only a few jobs but massive tax losses. Additionally, the expensing proposals would not apply to proprietorships, partnerships or Subchapter S corporations, which make up most of the small businesses which these proposals are ostensibly trying to help.

In my view, enterprise zones represent a modest but exciting new approach with potential for charting new means to deal with hardcore unemployment in particularly distressed areas of America's cities and rural towns. It seeks for once to get Government out of the way and to level the playing field so that the private enterprise system can succeed in less attractive areas and create jobs for the poor, which might never otherwise have existed. It envisions a framework of incentives and opportunities that channel entrepreneural behavior into productive activities.

This is the essence of enterprise zones. Enterprise zones incorporate a unique, innovative approach for dealing with the twin scourges of unemployment and blight. Enterprise zones seek to reverse the outmigration of human and physical capital from depressed areas, not through heavyhanded Government intervention, which distorts the economic system, but through removal of city-State-Federal burdens on free market forces.

I am confident that in the long run, enterprise zones can stimulate a gradual restoration of local tax bases so that once-depressed areas can again enjoy healthy, self-sustaining economic growth. As the President said in his state of the Union message, "I hope we can work together on this as we did last year in enacting the landmark Job Training Partnership Act. Passage of enterprise zone legislation will also create new incentives for jobs and opportunity."

In this spirit, I urge the committee and Congress to give this proposal expeditious and favorable consideration. Now I am ready to try to answer any questions you may have.

[The statement of Secretary Pierce follows:]

STATEMENT OF SAMUEL R. PIERCE, JR., SECRETARY OF THE DEPARTMENT OF HOUSING AND DEVELOPMENT

TESTIMONY BY SAMUEL R. PIERCE, JR.

SECRETARY OF THE DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

ON THE ENTERPRISE ZONE EMPLOYMENT AND DEVELOPMENT ACT OF 1983 (S. 863)

BEFORE THE SENATE FINANCE COMMITTEE

APRIL 22, 1983

Mr. Chairman, I am pleased to appear this morning to testify on behalf of the Enterprise Zone Employment and Development Act of 1983 (S. 863). I am encouraged by the bipartisan support of so many Senators for this bill. I welcome the early scheduling of these hearing as evidence that the Senate views the need for establishing and implementing this program with the same urgency that the Administration and numerous States and cities do.

When a similar bill cleared this committee last year, Enterprise Zones in the United States were regarded as relatively unknown and experimental. Today, however, well over a dozen states are implementing their own Enterprise Zone programs, and roughly fifteen states have legislation pending. Thus, the Enterprise Zone concept is increasingly being tried as a method for stimulating private sector employment and economic growth in place of despair and decline. . This progressive State activity will continue without waiting for the Congress to act, but it needs to be enhanced by the Federal tax and regulatory relief which S. 863 will bring.

There are many signs that the Nation is on the road to economic recovery. Much of this can be attributed to the new economic directions this Administration has charted with the bipartisan support of the Congress. Passage of the emergency jobs bill, the Job Training Partnership Act and tax relief legislation have been important steps. But to continue our economic progress, we must generate permanent jobs, especially for the long-term unemployed and disadvantaged workers. Without jobs for its residents no community can be revitalized or prosper.

Economic recovery and the creation of jobs call for action and leadership at all levels. It requires a broad-based, constructive partnership among Federal, State and local governments and private industry. Although governmental assistance for economic development such as UDAG and CDBG continues, it must be augmented by fresh approaches to enhance the local business climate. The key to new jobs and a sound economy is a healthy private sector. Indeed, a vibrant private sector turns the wheels of our Nation and is the key to a decent quality of life in our communities.

This why the President has proposed reintroduction of the Enterprise Zone bill this year. This bill offers a new approach to revive areas where the private sector is dormant. It is a market-oriented approach, keyed to entrepreneurial activity, private sector job creation and community public/private partnerships. In constrast to past Federal efforts, it seeks to get government out of the way -- to reduce governmental burdens on the free enterprise system at the local, State and Federal levels.

The proposed Enterprise Zone legislation focuses on dealing with the economic distress of our Nation's cities. Its purpose is twofold: to create jobs in depressed areas, particularly jobs for disadvantaged workers and long-term unemployed individuals, and to redevelop and revitalize the distressed areas themselves.

Basic Concept /Program Structure

The concept underlying Enterprise Zones is the creation of an environment conducive to economic revitalization and job creation in economically distressed areas. It provides relief from taxes, regulations and other governmental burdens, such as permit and licensing fees and procedures. It promotes improving municipal services and infrastructure. It directly involves private entities, organizations, neighborhood associations, and citizen groups from the zone area. It encourages local and State governments to actively and creatively work together as partners with the private and community sectors.

S. 863 contains several important additions to last year's legislation which reflect the combined wisdom of the growing coalition supporting this idea. It benefits greatly from ideas put forth by the small business community, State and local officials, labor organizations, and the many members of Congress who have studied and debated our earlier legislation. These improvements include: a rural setaside; a reduction in the zone minimum population requirement for jurisdictions with population of less than 50,000; joint city/state certification of eligibility; exemption of designation itself, but not activities following designation, from NEPA and related laws; preservation of potential eligibility for tax credits in State-designated zones that are subsequently Federally designated; and an evaluation provision. The net result is strong, farsighted legislation designed to unleash the creative energies of our free market economy in some of our most depressed areas.

Members of this Committee and others have helped enhance the participation of rural areas in this initiative. This year's bill requires that at least one-third of the 75 zones to be designated during the first three years must be in cities of 50,000 or less and located in rural areas. In addition, we have lowered the minimum population requirement for such zones from 2,500 to 1,000.

As Senator Chafee so aptly stated when S. 863 was introduced, "The purpose of this is to move ahead slowly, to get some experience, to see whether we are embarking down the right road . . ." We feel the creation of up to 75 zones over a three year period will provide a prudent but diverse opportunity to evaluate the potential of the Enterprise Zone concept all across the country.

Under S. 863, local and State governments will nominate eligible areas for Federal Enterprise Zone designation. Communities which are UDAG eligible -- in other words, communities with distress characteristics -- will be eligible for Federal Enterprise Zone competition. In addition, the area delineated within an eligible community must be one of pervasive poverty, unemployment, and general distress and meet an additional threshold of a fairly high level of poverty, or unemployment, or population loss, or low income. Within designated zones, the Federal government will offer the most potent package of tax incentives ever offered, together with regulatory relief.

A local and State government must jointly request Enterprise Zone designation of an area which they certify meets the statute's eligibility requirements. The core of the nomination process is the Course of Action, which outlines commitments which the local and State governments and the private sector have made or are prepared to make to improve the climate for job creation, economic growth, and revitalization within the zone. This Course of Action, while extremely flexible in terms of content, may well include tax reduction commitments, regulatory relief, improved local services and infrastructure, private sector job commitments, commitments from private groups to provide assistance to zone entrepreneurs, involvement of residents in a variety of ways, or other incentives tailored to local conditions and available resources.

As Secretary of HUD, I will not insist on inclusion of any particular incentive of tax or regulatory relief. A weakness of incentives in one area, such as tax relief, could be offset by greater strength in another area, such as private sector commitments or improved services. Preference will be given to zones with the strongest and highest quality Course of Action, and broadest support and commitment by private entities, organizations, neighborhood associations and community groups all of which would auger well for the success of the zone. I will particularly welcome innovative ingredients which appear worthy of demonstration in a zone.

City / State / Federal -- Private Partnership

In my view, Enterprise Zones constitutes creative Federalism at its best -- it encourages city-state cooperation in addressing the problems of distressed areas as a prerequisite to possible Federal assistance. It encourages those at the grassroots level to develop strategies tailored to local conditions and opportunities aimed at physical revitalization and job creation. Development of this city-state cooperative strategy might include

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such elements as: honestly assessing the business climate within a locality, including both its assets and weaknesses; providing an appropriate mix of incentives to attract business investment; examining means to improve the delivery of municipal services and strengthen infrastructure such as sewers and roads; giving neighborhood-based groups a stake in the development and implementation of the zone, and forging working partnerships with businessmen to harness private sector commitments to economic expansion and job creation activities.

The role we are asking cities and States to play is not a new one. In recent years, many cities and States throughout this Nation have taken the initiative to meet local and statewide economic development needs. A variety of incentives have been developed which parallel the basic thrust of this legislation. However, Enterprise Zone legislation takes us one step further by encouraging States and local governments to focus resources, in addition to Federal incentives, on discrete distressed areas of our country. The fact that 48 States and hundreds of cities are now working together to design State-administered Small City Community Development Block Grant programs demonstrates that such partnerships are real and can work.

State and local governments have already exhibited remarkable enthusiasm for the Enterprise Zone idea. Sixteen states have already enacted Enterprise Zone legislation, 5 so far this year, and 15 additional states have legislation pending. I am submitting for the Record a summary of State Enterprise Zone legislative activity.

These States and their local governments have displayed considerable creativity in their free-standing Enterprise Zone efforts. In Kentucky, for example, the legislature has passed a bill providing for the establishment of Neighborhood Enterprise Associations. These Associations would be incorporated bodies of residents in Enterprise Zone neighborhoods. Unused State and local property within the Association's area would be leased to the Association for nominal amounts, and the Association would be exempt from State and local taxes. Providing zone residents with this equity interest will enable them to participate in the economic success of the zone and develop a greater sense of commitment by the residents to their neighborhoods.

The State of Connecticut has enacted comprehensive Enterprise Zone legislation and six zones have been designated. Local activity is moving ahead in these zones. The Connecticut legislation provides for:

- $1.0 million in venture capital loans to small businesses;
- a 50% State corporate income tax credit;
- $1,000 to manufacturers for each new job created;
- a sales tax exemption on purchase of spare or replacement parts;
- employment training vouchers; and
- phasing in of property tax assessments for new construction over a seven year period.

Other states have also provided a wide variety of incentives for businesses in their zone legislation. These include Maryland, which provides loan guarantees from the Venture Capital Guarantee Fund; and Florida, which provides for loans and grants to community development corporations (CDCs) in State Enterprise Zones. Also, within some 400 potential zones, Louisiana provides exemptions from State income, sales and franchise taxes for purchase of plant and equipment; and Ohio, which provides sales tax exemptions and permits property tax abatement. Pennsylvania is implementing an Enterprise Zone program using existing legislative authority, and Georgia recently passed legislation for Atlanta to have an Enterprise Zone program soon.

Many communities, from California to Connecticut, from Ohio to Louisiana, are actively working on implementing their own Enterprise Zones. Cleveland is developing a "Target Area Investment Program". San Jose has a "Central Incentive Zone Program". Other cities also are testing the Enterprise Zone concept with or without State enabling legislation.

We want to encourage these efforts. This is a wonderful opportunity to demonstrate public/private partnerships in action. The Enterprise Zone bill provides an important and necessary complement to such State and local activities. For this reason, the Enterprise Zone Employment and Development Act of 1983 includes a useful new provision that preserves potential eligibility, once zones are Federally designated, for Federal Enterprise Zone employment tax credits for businesses that hire qualified workers after a zone receives State Enterprise Zone designation but before Federal designation. This idea was suggested to us last year by Senator Durenberger, and we have included it in this years legislation to better harmonize State and Federal efforts.

Since economic activity is weak or non-existent in potential Enterprise Zone areas, the cost of State and local tax relief could be modest. If the program is successful in stimulating new economic activity there, tax relief costs could be substantially offset through reduced expenditures due to the employment of individuals formerly receiving government assistance and increased real property and business tax collection which scarcely existed before. States and communities can use CDBG, UDAG, and Revenue Sharing funds as part of their package of commitments.

Federal Incentives

Once an area has been designated by the Secretary of HUD, after the competitive process, to be a Federal Enterprise Zone, a number of incentives become available that are designed to achieve two crucial goals:

1. First, to create a new sense of economic potential within the zones, by dramatically expanding opportunities for successful entrepreneurial activity. The bill does this by:

    - Eliminating capital gains taxes on qualified properties within the zones.

    - Providing, over and above all existing credits, an additional nonrefundable investment tax credit for capital investments in an Enterprise Zone:

3% to 5%for personal property, such as machinery or equipment;

10% for the construction or rehabilitation of commercial, industrial, or rental housing structures within a zone.

- Providing that unused investment tax credits may be carried over for the life of the zone or 15 years, whichever is longer.
- Insuring the continued availability of Industrial Development Bonds (IDBs) to small businesses in Enterprise Zones even if such bonds are terminated elsewhere after 1986, and use of accelerated cost recovery for IDB-financed property.

2. Second, the bill seeks to encourage the hiring and training of disadvantaged workers and the expansion of payrolls, and recognizes the fact that persons on welfare may face the highest marginal tax rates of all. The latter situation creates a poverty trap for millions of Americans. To encourage the poor, when able, to seek taxpaying jobs and to encourage job creation within Enterprise Zones, the bill provides a nonrefundable 5 percent income tax credit to employees for the first $10,500 in wages earned in zone employment. This added $400-$500 in a worker's pay envelope will enhance the real income of those moving from receiving welfare and/or unemployment benefits to private sector take-home payments.

To stimulate labor-intensive businesses to locate in zones and to encourage the hiring and training of workers, particularly disadvantaged persons, the bill provides the following incentives for employers:

- A special strengthened, nonrefundable income tax credit for hiring disadvantaged workers, equal to 50 percent of the workers' wages for three years, phasing down to 40 percent, 30 percent, 20 percent, and 10 percent over the following four years. This credit has no cap, which gives the employer a major incentive to hire, train and to promote disadvantaged workers into higher-wage jobs. It encourages each employer to set up his own job training program, tailored to the specific needs of his business, rather than being locked in to the rigid requirements of a government-run training program.

- A nonrefundable 10 percent income tax credit to employers for the first $17,500 in payroll paid to qualified zone employees (for businesses already existing in a zone, this is 10 percent of the increase in payroll paid to such employees in the year prior to zone designation).

- A carryover of any unused employment tax credits for the life of the zone in which a firm is located or 15 years, whichever is longer, and a carryback of up to three years.

On the regulatory side, State and local governments which receive Federal Enterprise Zone designation will be authorized jointly to petition for relief in their approved zones from any Federal regulation not specifically required by statute. Federal regulatory bodies will be authorized to weigh these requests under Congressionally-mandated standards, and to relax the regulations when it is in the public interest to do so, given the goals of the Enterprise Zone program.

This special authority would expressly **not** apply to any regulations designed to protect any person or group against discrimination because of race, color, religion, sex, marital status, national origin, age, or handicap. It would also expressly **not** apply to any regulation the relaxation of which would be likely to present a significant risk to the public safety or health, including environmental health. The minimum wage law, for example, would **not** be included in the waiver authority because it is specifically set by statute at $3.35 an hour. OSHA and air quality standards would also not be subject to requests for relaxation or waiver.

Beyond these sacrosanct areas, however, there are a myriad of regulations -- imposed by the Small Business Administration, Internal Revenue Service, HUD, Commerce and others -- which, if waived or relaxed, could enhance the success of Enterprise Zone entrepreneurs. I expect many helpful and informative lessons will be learned from intelligent application of this provision.

The Enterprise Zone bill also encourages establishment of foreign trade zones whenever possible and desired to provide relief from pre-payment of tariffs and import duties, and provides for expedited processing of foreign trade zone applications by the Commerce Department. This aspect has exciting potential for stimulating job-creating business activity in certain cities.

Because the proposed bill seeks to remove government burdens and increase State and local flexibility rather than providing government subsidies, it requires no direct Federal appropriation. In fact, increased business activity and job creation may actually in the long run provide increased revenues and cut costs by reducing the number of persons receiving unemployment and other support, not to mention providing people the dignity and satisfaction of having a job and enhancing the local property tax base. These revenue and cost reduction effects will be realized at the Federal, State, and local government levels.

The Treasury Department estimates that the cost of the Enterprise Zone program in FY 1984 would be $87 million, since the tax incentives would affect taxable years beginning after January 1, 1984. The cost in terms of foregone revenues in FY 1985 has been conservatively calculated at $400 million, upon the assumption that the increased business activity would have occurred in any event elsewhere. The total cost of the program would then increase commensurately in future years as the number of zones and the pace of activity in them increases. These estimates do not reflect costs offset by secondary and tertiary benefits which will result, such as reduction of welfare and unemployment costs, new tax revenues, enhanced local tax bases, and other economic ripple effects.

Small Businesses

Expectations are that Enterprise Zones will provide a home primarily medium and small sized businesses. Given that assumption, concern has been expressed that since new, small businesses generally have low profitability and low tax liability in their formative years, they will not be attracted or assisted by Enterprise Zone tax incentives.

That concern fails to recognize that the Enterprise Zone initiative is not just a Federal tax incentive program. It is a major effort to encourage removal of all types of government impediments to economic activity at the Federal, State, and local levels. It will generate the development of comprehensive strategies, tailored to local conditions and aimed at creating an atmosphere conducive to private sector activity.

Regulatory relief will help small businesses since regulations impose costs which businesses must bear regardless of whether they make a profit. Such relief will be particularly important to small businesses. Large businesses can generally absorb the costs of regulation more easily, by such means as spreading the costs over more units of production, and are also better able to pass the imposed costs on to customers. Small businesses do not have these advantages.

Improved local services, whether increased police and fire protection or strengthened infrastructure or use of private sector providers, will also help small businesses. Such improved services will allow businesses to operate more efficiently and lower their costs.

State and local reduction of taxes which apply regardless of profitability can further help small businesses. These include property taxes and sales taxes.

Many of the Federal tax incentives also will help small businesses. The capital gains elimination will help small entrepreneurs who start and build up new businesses to receive the full value of their labor upon their sale.

The provision for the continuation of IDBs in Enterprise Zones will help small businesses obtain start-up capital. This incentive in particular does not rely on the tax liability of the small businesses, which is likely to be minimal at the outset, but rather on the more substantial tax liability of the lender, and consequently it should be effective in aiding small businesses.

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The carryover and the carryover of unused Enterprise Zone credits will allow small businesses which are successful to receive eventually the benefit of the zone incentives. The abatement of tariffs and import duties through the designation of Foreign Trade Zones in Enterprise Zones will also help small businesses since these taxes are again borne regardless of the profitability of the firm.

Tax relief should also help to encourage the establishment of small businesses in Enterprise Zones. All small entrepreneurs start businesses expecting to make a profit at least sometime within a 20-year period, which is the time for which Federal Enterprise Zone incentives may last. Tax relief will increase this expected profit and, therefore, should induce more small businesses to start in Enterprise Zones.

In addition, the Enterprise Zone incentives will encourage large businesses to locate branches within the zone. These branches will provide business opportunities for small, spin-off firms.

Front-End Capital

Concern has also been expressed about whether the proposed program sufficiently addresses a great problem faced by enterpreneurs attempting to start small businesses--obtaining necessary start-up capital.

Most new businesses are begun with the personal savings of the enterpreneur or savings from family or friends. Seventy-five percent of all new businesses start without using any outside debt or equity. Eight-nine percent of all start-up capital for new businesses comes from personal savings.

The chief reason small investors start and invest in a new business is to obtain the long-term profits they expect from the enterprise. The tax reductions and other elements of the Enterprise Zone program will increase these expected long-term profits. Consequently, the program should result in an increase in the private savings available for front-end investment in small businesses in Enterprise Zones.

These elements will also induce larger financial institutions to lend more money more freely to Enterprise Zone businesses. This is because these elements will increase the likelihood of profits and cash flow of these businesses out of which such loans are to be repaid. With increased assurance of profits and cash flow, the risk attached to such loans is reduced, and financial institutions are more likely to make them.

The program thus should result in a substantial increase in the availability of front-end capital for viable businesses which have reasonable profit potential over the long run. These incentives, of course, will not do much good for firms suffering chronic losses without any foreseeable profit prospects. The Enterprise Zone program is intended to attract healthy, economically sound, profitable businesses to the zones which can serve as the basis for long-term job creation and economic growth.

Moreover, since industrial development bonds (IDBs) will continue to be available for small businesses within Enterprise Zones, they in effect would eliminate taxation on the interest received by a lender to a small zone business. This would increase the return to the lender on such loans and, therefore, should increase the availability of such loans.

The inclusion of a so-called "expensing" provision, which some people have suggested, would not be an effective or targeted means of providing front-end capital for small businesses. Most "expensing" provisions would allow the deduction of all or a portion of the amount of an investment in a zone business from gross income in computing tax liability. Unfortunately, "expensing" could introduce an extraordinary opportunity for waste and abuse, because funds generated through "expensing" could be used for any purpose, including those which do not result in any job or redevelopment activity. In fact, in general, the most beneficial use of funds generated through "expensing" is to purchase and hold inventory, warehouse goods, or assets subject to appreciation. The tax incentives offered in S. 863, on the other hand, cannot be used to support the purchase of idle assets but must be used to improve plant and equipment or to hire and train workers.

Should an "expensing" provision be adopted, we envision scores of store front operations through which sales actually consumated outside the zone are supported by warehouses inside the zone, creating only a few jobs but massive tax losses. Additionally, the "expensing" proposals would not apply to proprietorships, partnerships, or subchapter S corporations which make up most of the small businesses which these proposals are ostensibly trying to help.

Conclusion

In my view, Enterprise Zones represent a modest, but exciting new approach with potential for charting new means to deal with hard core unemployment in particularly distressed areas of America's cities and rural towns. It seeks, for once, to get government out of the way and to level the playing field, if you will, so that the private enterprise system can succeed in less attractive areas and create jobs for the poor which might never otherwise have existed. It envisions a framework of incentives, or opportunities, to channel enterpreneurial behavior into productive activities. This is the essence of Enterprise Zones.

Enterprise Zones incorporate a unique, innovative approach for dealing with the twin scourges of unemployment and blight. Enterprise Zones seek to reverse the outmigration of human and physical capital from distressed areas -- not through heavy-handed government intervention which distorts the economic system but through removal of city-State-Federal burdens on free market forces. I'm confident that, in the long run, Enterprise Zones can stimulate a gradual restoration of local tax bases, so that once depressed areas can again enjoy healthy, self-sustaining economic growth.

That is the key to this bill. It encourages local and State governments to take the initiative, and actively and creatively work together as partners with the private and community sectors to create an environment for economic revitalization and job creation in the distressed areas of our Nation's cities and rural towns.

As the President said in his January 25, 1983, State of the Union Address, "I hope we can work together on this, as we did last year in enacting the landmark Job Training Partnership Act . . . Passage of enterprise zone legislation will also create new incentives for jobs and opportunity."

Enterprise Zones offer a means to focus innovation, strategic planning, incentives, and resources on distressed areas. This is an approach whose time has come. Enterprise Zones offer a new way to stimulate job creation and revitalization. In this spirit, I urge this Committee and Congress to give this proposal expeditious and favorable consideration.

STATE ENTERPRISE ZONE LEGISLATION

States With Legislation Enacted:

1. Arkansas
2 Connecticut
3. Florida
4. Georgia (for Enterprise Zones in Atlanta)
5. Illinois
6. Indiana
7. Kansas
8. Kentucky
9. Louisiana
10. Maryland
11. Minnesota
12. Mississippi
13. Missouri
14. Ohio
15. Rhode Island (effective upon passage of Federal legislation)
16. Virginia

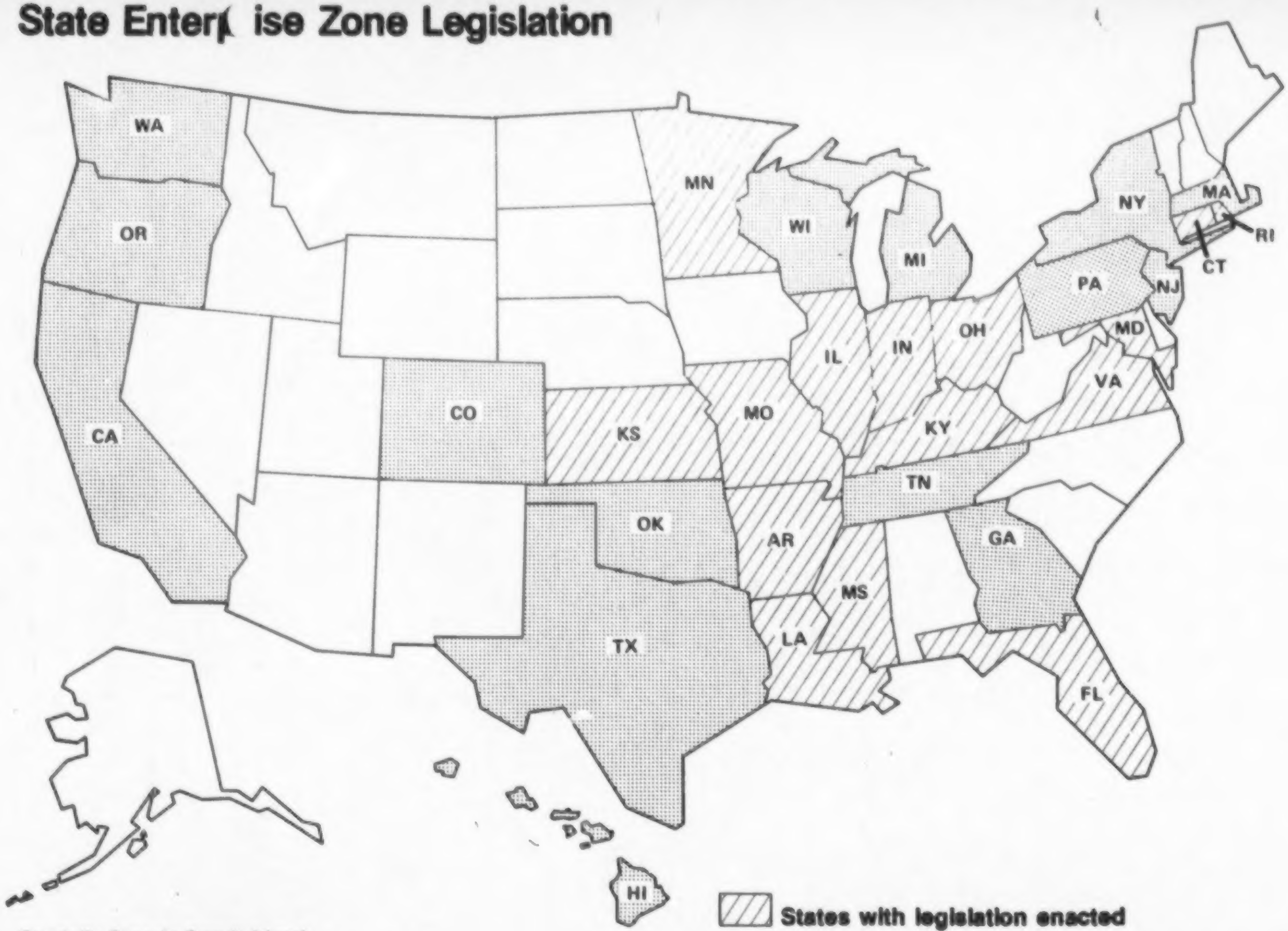
States With 1983 New Legislation Pending:

1. California
2. Colorado
3. Hawaii
4. Massachusetts
5. Michigan
6. New Jersey
7. New York
8. Oklahoma
9. Oregon
10. Pennsylvania
11. Texas
12. Tennessee
13. Washington
14. Wisconsin

States with 1983 Amendments to Existing Legislation:

1 Connecticut
2. Illinois
3. Kansas
4. Maryland
5. Minnesota
6. Missouri
7. Rhode Island
8. Virginia

State Enterprise Zone Legislation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CT
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▨ States with legislation enacted

▩ States with 1983 new legislation pending

Georgia (for Enterprise Zones in Atlanta)
Rhode Island (effective upon passage of Federal legislation)
Indiana (passed both houses of legislature)

The **Chairman**. Mr. Secretary, thank you very much. I just want to ask a general question that I think you have more or less answered in your last statement.

This is a matter of high priority, as I understand it, with the President, with you and with the administration this year. Is that correct?

Secretary **Pierce**. It certainly is. It has the highest priority.

The **Chairman**. And I know there is growing support around the country. As I have indicated earlier, I have had a chance to visit just one area in Toledo, Ohio and we will have witnesses from that city later on, but there are a number of States, a number of cities and a number of people in the private sector who aren't waiting for Federal legislation, but who would be reinforced to do more if in fact we had Federal legislation in place.

So it seems to me that where we have enough support I believe is in the Senate and certainly within this committee, but I think the one area that we are concerned about is a group called the House of Representatives.

Is there any strategy being developed to get their—I won't say get their attention because they are aware of this, but to really enlist some strong support for enterprise zone legislation?

Secretary **Pierce**. Yes; we are working on that. You had Congressman Garcia before you and he is doing a great deal of work with his Democratic colleagues in the House. We are paying personal visits to leading Members of the Congress. And through our efforts and the efforts of our friends in the House, both on the Republican and Democratic sides, we do expect to get relatively quick action in that body also.

The **Chairman**. I notice in your testimony, I think Illinois has State enterprise zone legislation. I am not certain that gets as far as Chicago, but that would be of interest, I assume, to the chairman of the Ways and Means Committee.

Senator Heinz.

Senator **Heinz**. Mr. Chairman, thank you.

Secretary Pierce, one of the criticisms of the administration's bill is that there is going to be perhaps a fairly decent incentive for business firms, particularly the subsidiaries of large corporations that have taxes owing to the Federal Government that they can offset tax credits, accelerated depreciation or other tax benefits against, but that in the enterprise zone area there will be not surprisingly a large number of indigenous businesses that are not so profitable that will have to compete against these new arrivals in the zone. They will not have access to the kinds of lower cost capital that the larger enterprises presumably would have access to. And therefore they will be strongly disadvantaged in competing with the new arrivals in the zone, with the result that they may go out of business.

And even if the new enterprise succeeds in the zone, there will not necessarily be a net increase in employment, which of course is the goal of the legislation.

It is further argued that some of the provisions in the administration bill are insufficiently, for the reasons mentioned a moment ago, insufficiently sensitive to the fact that one of the things that helps businesses succeed is what we might call community support and acceptance, and that this in itself is an important factor, not only in the way a business community is welcomed by local residents, but indeed, welcomed by the jurisdiction—the city, the county—into that particular area.

Now a number of proposals have been suggested for dealing with this, one of which is to make the tax credits refundable. Another would be to provide the equivalent of what you might call safe harbor leasing, again for the indigenous firms, so that they could sell the tax breaks and thus take advantage of the fact that they don't have the large tax bill with which to fully take advantage of the tax incentives here. There are indeed other proposals aimed at solving this problem.

Would you care to comment to the committee on whether you think this is a real problem, and if you do think it is a real problem, what do you think are the best alternatives the committee should look at in addressing the problem?

Secretary PIERCE. I think that what we should always keep in mind is that this legislation is experimental in nature. What we have done is to put into the bill things that we believe will give the incentives necessary for businesses to be successful in those areas. We do not contend for 1 minute that we have put into the bill every possible alternative.

I think, however, it would be wise to pass the bill and we will have a close monitoring system with respect to it, and we will observe and see what has to be done, if anything, to make the enterprise zone system more effective.

Frankly, there are many ideas. There are ideas of expensing, which we do not agree with. There are ideas for additional tax credits of various kinds. There are ideas for having neighborhood corporations.

There are many ideas, but for a variety of reasons, we do not think that they are necessary and, in some instances, would be even worthwhile putting in the bill.

Senator HEINZ. Mr. Chairman, might I just ask a followup question, with the permission of the committee?

The CHAIRMAN. Yes.

Senator HEINZ. Mr. Secretary, I am not asking you to endorse any new ideas. I would certainly welcome any comments or endorsements, but I am not asking you to do that specifically.

The reason you didn't have very much time to answer the question, however, is that I wanted to pose as clearly as I might to you what I believe to be a real problem. The first part of my question was, and I tried to make the explanation fairly specific, is I wanted to get your views as to whether the problem that I was talking about—namely, the disadvantaging, unless we address it in some way, shape or form, of existing businesses—could undermine what you and the administration want to accomplish.

In other words, I am not looking for a cure for the problem today. I am looking to find out if you agree that indeed, there may be some kind of a problem.

Secretary PIERCE. I would like you to be a bit more specific, but I think what you are saying is that a new business would come into an enterprise zone and would have all of the advantages of getting tax credits, for example, with respect to employees and employers, but an existing business would only get that tax advantage with respect to new employees that are hired.

Is that the problem?

Senator HEINZ. That could happen. That wasn't really the thrust of the problem, though. The thrust is this: that the firms in the zone right now aren't too terribly healthy. They don't make a lot of money. They don't pay a lot of taxes in most cases. Therefore, they can't take advantage of tax credits, which are not refundable.

It is a guess on my part, but on the part of a lot of other people who have studied this concept, that the businesses most likely to locate in these zones will be subsidiaries of large, profitable corporations.

Secretary PIERCE. Well, I don't necessarily agree with that. I think that——

Senator HEINZ. Mr. Secretary, you can disagree with me as soon as I finish. But there has been a good deal of testimony given to this committee on that point, that you can expect profitable companies to come and locate their subsidiaries in these kinds of zones.

Now if that is true, and you may not agree that that is true, but if that is true, do you see a problem?

Secretary PIERCE. Well, I don't like to speculate. I want to give you what I believe. What I believe is that mostly small businesses will come into these areas. A lot of the big corporations would not come into these areas unless you provide them with some sort of taxing system whereby they would be a fool not to take advantage of it. That is one of the problems I have with expensing.

So unless you get into that, I think mostly of what you are going to get in those areas will be small businesses. As I said at the outset, I don't think anybody knows exactly how these zones are going to work. That is why we haven't said let's have 1,000 of them. That is why we have said let's have 75. Let's look at them. Let's see. And that is what I think we ought to do.

The CHAIRMAN. Senator Chafee.

Senator CHAFEE. Thank you, Mr. Chairman.

Mr. Secretary, as you have mentioned to the chairman, this legislation has high priority, and I just want to say, as one who has been involved in this for some years, we are going to require your very enthusiastic support and that of your department in shepherding this through.

You have helped us in the past and we count on that support in the future. While this committee appears to be receptive, and indeed the legislation passed out of here last year, we will have challenges on the floor inevitably. We count on you for that continued thrust that will be necessary.

Secretary PIERCE. You will have the full support of my department and myself.

Senator CHAFEE. Thank you very much.

The CHAIRMAN. Senator Long.

Senator LONG. Thank you, Mr. Secretary.

The CHAIRMAN. Senator Bradley.

Senator BRADLEY. Thank you, Mr. Chairman.

Mr. Secretary, there have been in many States in past years various tax abatement schemes for local municipalities to try to get business into those areas. How would you describe the difference between your normal local government tax abatement scheme and the urban enterprise zone?

Secretary PIERCE. Well actually, the urban enterprise zone is much more complex, involving much more than the local tax abatement schemes. It involves very important Federal tax advantages or incentives, as well as Federal regulatory incentives. It also involves cooperation of State and local governments and indeed, involves getting local and State governments to make the private sector get involved with the projects.

So therefore, it is a much more complex thing and involves what I would like to term a public-private partnership effort.

Senator BRADLEY. As you were devising the strategy, what one or two things did you feel were absolutely necessary? I mean you have mentioned taxes, regulatory assistance. What one or two things, if they were removed from this bill, would gut the bill?

Secretary PIERCE. Well, if you remove almost any provision, I would argue that it would hurt the bill a great deal. I would hate to see, for example, the 5 percent tax credit given to employees taken away. That was taken out of the bill last year. I would not like to see that done again this year.

Senator BRADLEY. A concern that I have heard expressed about urban enterprise zones, though let me say generally that I think it is a very good program and I hope that it will pass, but that there is a concern expressed that the workers that will work in the urban enterprise zone won't come from the areas that surround the urban enterprise zone, but they will basically commute in from the suburbs.

What is your response to that?

Secretary PIERCE. I don't necessarily think that will be the case.

Now there are some of these zones where they really don't have very many people in them at all, and actually you will have to try to get people to come in, particularly in businesses that involve skilled labor. But I think, if neighborhood people get involved in the enterprise zone, you will get many workers right from the area. I think it can be very important to them and very important to State and local governments, as well as to the Federal Government, because I think it will take a lot of them off of public assistance rolls.

So I believe enterprise zones can work, and I would like to see them tried. There are, I know, a lot of projections and estimations involved, and again, I emphasize that we are in an experimental stage, but one that I think will come out very well.

I might mention that we have been watching England very closely. We got the idea from England. They have been doing quite well. In fact, I had the opportunity of speaking with the urban affairs minister of England recently at a conference, and they seem to be doing quite well with it.

Senator BRADLEY. Have you specifically excluded the possibility of more than one urban enterprise zone in a State?

Secretary PIERCE. No.

Senator BRADLEY. Thank you very much.

The CHAIRMAN. Like New Jersey or Kansas?

Senator BRADLEY. Or Louisiana or Pennsylvania.

The CHAIRMAN. Right, and Ohio is represented in the audience.

Mr. Secretary, we appreciate very much your testimony and we will be working with you and members of your department. But I think you sense a fairly strong support on this committee, or at least you should. I note that five of the states that now have enterprise zone legislation are represented on this committee, and a number of states where legislation is pending.

So there is an interest in our states and that will also have an impact on what may happen here.

Thank you very much.

Secretary PIERCE. Thank you very much.

The CHAIRMAN. Senator Boschwitz was to be the next witness, but he is not here. So we are very pleased to call Bill McKee, Acting Deputy Assistant Secretary for Tax Policy, the Treasury Department. I wonder if we might have Frank Swain also, Chief Counsel for Advocacy, Small Business Administration. Is Mr. Swain here?

I would like to suggest, if we might, since we still have 13 witnesses and some have weekend plans, including the Chairman, that we might summarize our statements. We know the Treasury statement is outstanding and I am certain that the one from the Small Business Administration is also, so we can go into some questions.

Bill, do you want to start off?

STATEMENT OF WILLIAM S. McKEE, ACTING DEPUTY ASSISTANT SECRETARY FOR TAX POLICY, DEPARTMENT OF THE TREASURY

Mr. McKEE. Mr. Chairman and members of the committee, I am pleased to have the opportunity to appear before you today to discuss the Federal tax features of the Administration's enterprise zone program.

The enterprise zone program is an experimental initiative designed to relieve economic distress in the inner cities and rural towns. The program is structured to create a free market environment in depressed areas through the removal of government burdens. This should create and expand economic opportunities within the zones, leading to an expansion of economic activity and the creation of jobs within these areas.

While the Federal tax incentives are an important part of the program, unlike many of the past programs to deal with the economic problems of depressed areas, the success of the enterprise zone program will depend largely on contributions made by State and local governments through improved services and through relief of local taxes, regulations and other burdens that may inhibit economic activity in these designated areas.

Senator LONG. Mr. Chairman, could the witness talk a little more slowly? Where I come from, people talk a little more slowly.

The CHAIRMAN. Would you summarize a little more slowly?

Mr. McKEE. Thank you, Mr. Chairman. Senator Long, I would be happy to comply.

Since the enterprise zone concept is designed to create a free market environment for business, the intent is not to foster a particular kind of business activity. The Federal tax features of the program contain not only strong incentives for labor-intensive businesses in the creation of jobs through employment credits, but also include a number of tax credits and other incentives for the formation of capital.

On the whole, the effect of the Federal tax package will be one: (1), To reduce significantly the tax payable by employers on ordinary income generated by activities in the designated zones, (2) to eliminate entirely the capital gains tax on certain types of property used primarily within the zones; (3) allow the continued use of exempt small issue industrial development bonds financing zone activities, (4) to provide income tax relief for qualified zone employees of firms doing business within a designated zone.

I would now like to outline the major features of the Federal income tax incentives for businesses operating within a designated zone area.

First, credits for employers. There are two separate payroll credits for employers doing business in zones. One is designed to encourage the creation of new employment generally, and the other is a targeted incentive to encourage the hiring and training of certain disadvantage individuals.

The first credit is a nonrefundable 10-percent income tax credit to enterprise zone employers for payroll paid to qualified zone employees in excess of the payroll paid to such employees in the year prior to zone designation. Wages taken into account for purposes of this credit are limited to two and a half times the FUTA wage base, currently $7,000, per employee. Thus, the current maximum credit will be 10 percent of each employee's wages, up to $17,500, or a credit of $1,750 per employee.

The 10-percent credit is designed to attract labor-intensive business activities to the enterprise zone areas and encourage firms already operating within those areas to expand. With a cap of $17,500 on wages to which the credit applies, the incentive is focused on jobs for unskilled workers and those with some training but still in the lower middle income brackets.

The second payroll credit is a special nonrefundable income tax credit to employers for wages paid to zone employees who were disadvantaged when hired. This credit will be 50 percent of wages paid without limit to each disadvantaged individual during each of the first three years of employment, declining by 10 percent per year thereafter.

The definition of disadvantaged workers is focused on low income and hard to employ individuals. The list of disadvantaged workers includes general assistance recipients, economically disadvantaged individuals and eligible AFDC recipients.

This special credit is the strongest tax incentive ever provided for the hiring of disadvantaged workers. The three-year duration and the phase-out will provide the employer with sufficient time to undertake a long-term training program addressed to the needs of the most disadvantaged workers.

For employee credits, in addition to the regular and special payroll credits, a zone employer's payroll costs will be reduced by an allowable employee credit. A zone employee will be entitled to a nonrefundable 5-percent income tax credit for wages earned in zone employment up to one and one half times the FUTA wage base, again $7,000. Thus, the current maximum credit will be 5 percent of $10,500, or a credit of $525 per employee.

The tax credit will increase take-home pay to qualified employees who work in the zone. Such a benefit will be an important factor to induce workers to accept employment within the zones, which may initially be somewhat undesirable places to work.

As I mentioned earlier, the Federal tax incentives contain not only strong incentives for labor-intensive businesses, but also provide stimulus for capital investment in the zones through special investment tax credits. On top of the regular tax credit allowable, an additional nonrefundable investment tax credit is provided for capital investments in an enterprise zone.

For personal property, such as machinery or equipment, this additional credit will be 3 percent for property in the three-year ACRS class, and 5 percent for all other property eligible for the ITC. This represents a 50-percent increase in the ITC generally available.

In addition, a new 10-percent credit will be provided for the construction or rehabilitation of commercial, industrial or rental housing structures within a zone.

Capital gains will be accorded favorable tax treatment within enterprise zones to stimulate investment in the zones by real estate developers and by entrepreneurs and venture capitalists seeking to start and build new businesses in the zone.

Specifically, with certain exceptions to prevent abuse, long-term capital gain from the sale of tangible property used in a zone business, or from the sale of an interest in a zone business, will be exempt from Federal income tax. This provision should attract to the zone new small businesses with substantial growth potential, and more generally encourage capital improvements within the zone areas.

In addition to the special investment tax credits and the special rule for zone capital gain, the preservation of the use of small issue industrial development bonds will help small businesses to obtain low-cost financing to begin or expand their ventures. At the present time, most property financed with small issue IDB's are subject to reduced ACRS deductions, and the provision in general is scheduled to sunset at the end of 1985. The bill will remove both the ACRS restriction and the sunset date for the entire period during which an area is designated as an enterprise zone.

Because we are not certain of the number, size and characteristics of the actual zones to be designated, the revenue estimates for this bill can be expected to change as the zones are actually designated by HUD. Also, the revenue costs increase in future years as the number of zones and business activity within each zone increase. We are projecting revenue losses of $.1 billion in 1984, $.4 billion in 1985, growing to $1.1 billion in 1987.

Concluding my remarks, I would like to emphasize that the enterprise zone program represents a fresh approach for dealing with the problems of economically distressed areas. Unlike the programs put forth in the past, enterprise zones should spur economic activity by removing one of the largest barriers to its growth—excessive governmental regulation.

We are confident that the total program contains the ingredients necessary to make it a success. Thank you very much.

[The statement of Mr. McKee follows:]

STATEMENT OF WILLIAM S. MCKEE, ACTING DEPUTY ASSISTANT SECRETARY (TAX POLICY), DEPARTMENT OF THE TREASURY

For Release Upon Delivery
Expected at 9:30 a.m.
April 22, 1983

STATEMENT OF
WILLIAM S. McKEE
ACTING DEPUTY ASSISTANT SECRETARY
(TAX POLICY)
DEPARTMENT OF THE TREASURY
BEFORE THE SENATE FINANCE COMMITTEE

Mr. Chairman and Members of the Committee:

I am pleased to have the opportunity to appear before you today to discuss the Federal tax features of the Administration's enterprise zone program.

The enterprise zone program is an experimental initiative designed to relieve economic distress in inner cities and rural towns. The program is structured to create a free-market environment in depressed areas through the removal of government burdens. This should create and expand economic opportunities within the zones leading to an expansion of economic activity and the creation of jobs within these areas. While the Federal tax incentives are an important part of the program, unlike many of the past programs to deal with the economic problems of depressed areas, the success of the enterprise zone program will depend largely on contributions made by the State and local governments through improved services and through relief of local taxes, regulations, and other burdens that may inhibit economic activity in these designated areas. In addition, the program is dependent upon the involvement of private organizations. Efforts will be made to experiment with private firms providing traditional city services, and more involvement by private-sector neighborhood organizations will be encouraged.

Since the enterprise zone concept is designed to create a free-market environment for business, the intent is not to foster a particular kind of business activity. The Federal tax features of the program therefore contain strong incentives for labor-intensive businesses and the creation of jobs through employment credits, and also include a number of tax credits and other incentives for the formation of capital. On the whole, the effect of the Federal tax package will be to reduce significantly the tax payable by employers on ordinary income generated by activities in designated zones, eliminate entirely the capital gains tax on certain types of property used primarily within the zones, allow the continued use of exempt small issue industrial development bonds issued with respect to zone activities, and provide income tax relief for qualified employees of firms doing business within a designated zone.

I would now like to outline the major features of the Federal income tax incentives for businesses operating within a designated zone area.

A. Credits for Employers

There are two separate payroll credits for employers doing business in the zones. One is designed to encourage the creation of new employment generally, and the other is a targeted incentive to encourage the hiring and training of certain disadvantaged individuals.

These payroll credits will be nonrefundable and will be available only with respect to "qualified employees," i.e., those who perform 50 percent or more of their services within an enterprise zone and at least 90 percent of whose services are directly related to the zone business. The amount of these credits will reduce the employer's deduction for wages. For zones lasting between 21 and 24 years, both credits will phase out during this period, declining by 25 percent per year.

1. Credit for increased enterprise zone employment.

The general payroll credit for enterprise zone employers will be equal to 10 percent of their "qualified increased employment expenditures." This is the amount by which the payroll for qualified employees in any taxable year exceeds the payroll for the base period, which is generally the 12-month period prior to zone designation. Qualified wages are limited to 2-1/2 times the FUTA wage base (currently $7,000) per employee. Thus, the current maximum credit for qualified increased employment expenditures will be 10 percent of each employee's wages up to $17,500, or $1,750 per employee.

The 10-percent credit is designed to attract labor-intensive business activities to the enterprise zone areas and encourage firms already operating within those areas to expand. With a cap of $17,500 on wages to which the credit applies, the incentive is focused on jobs for unskilled workers and those with some training but still in the lower middle income brackets.

The credit is available to all employers for the qualified workers they employ within the zones, regardless of how many workers they employ elsewhere or what business activities they engage in outside of the zones. The credit will apply to wages paid by existing firms to net, additional workers, representing an increase in the firm's work force, subject to the annual maximum wage cap per worker. The credit will also apply to increased wages paid to existing workers and wages paid to replacement workers, above the total sum of wages paid to the former workers, all subject to the maximum annual wage cap per worker. However, the credit generally does not apply to the existing payroll of an existing business within a zone at the time it is so designated, nor does it apply to a worker hired by such a firm to replace a former, pre-zone worker making the same wage.

As an example of how the credit is to work, assume that in a 12-month period prior to zone designation an employer employs two persons, A and B, at an annual salary of $12,000 each in an area which is to be designated as an enterprise zone. Since the employer's $24,000 pre-zone payroll is within the $17,500 per employee limit, that amount represents the base period wages. If after zone designation the employer gives each employee a raise of $1,000 per year, the employer's qualified payroll is $26,000 and its qualified increased employment expenditures are $2,000, qualifying it for a credit of $200. If in the next year the employer gives A a $7,000 raise (to $20,000), B a $2,000 raise (to $15,000), and hires a new employee, C, at an annual salary of $9,000, the employer's qualified payroll would increase to $41,500 ($17,500 of the $20,000 paid to A, $15,000 paid to B, and the entire $9,000 paid to C). This exceeds the $24,000 base period wages by $17,500, and the employer qualifies for a credit of $1,750.

2. Credit for employment of disadvantaged individuals.

In addition to the general payroll credit, enterprise zone employers will also be eligible for a special credit for wages paid to qualified employees who are disadvantaged individuals. This credit will be 50 percent of wages paid (without limit) to each disadvantaged worker during each of the first 3 years of employment, declining by 10 percent per year thereafter. On the day such individuals are hired, the individual must have received (or applied in writing for) a certification from a designated State employment security agency that such individual falls within one of the qualified categories.

This special credit is the strongest tax incentive ever provided for the hiring of disadvantaged workers. The 3-year duration and the phaseout will provide the employer with sufficient time to undertake a long-term training program addressed to the needs of the most disadvantaged workers. The definition of disadvantaged workers for purposes of this credit is focused on low-income and hard-to-employ individuals. The categories of disadvantaged individuals are:

(1) Economically disadvantaged individuals. These are persons who are members of a family that had an annual income equal to or less than that which an eligible family with no income would receive in food stamps plus AFDC benefits;

(2) General assistance recipients. These are individuals who are, within 60 days prior to hiring, receiving assistance under a State or local program that provides general assistance based on need and consists of money payments;

(3) Eligible AFDC recipients. These would include individuals qualifying for financial assistance under Part A of Title IV of the Social Security Tax Act who have received such assistance during the 90-day period immediately preceeding the hiring date.

The credit will be available to all employers for the disadvantaged workers they employ within the zones, regardless of the number of workers or amount of business conducted elsewhere. Additionally, the credit will apply only to disadvantaged workers hired after designation of the zone in which they are employed. These workers do not have to represent net additional workers or an increase in their employer's work force. The credit will therefore not apply to the past payroll of an existing business in a zone, but will apply, for example, to the replacement with disadvantaged workers of workers lost through attrition. Since the credit is intended to encourage the training and permanent employment of these disadvantaged individuals, the credit, with certain exceptions, generally will be recaptured if an individual is dismissed or fired within 9 months after being hired.

B. Employee Credits.

In addition to the regular and special payroll credits, an enterprise zone employer's payroll costs will be reduced by the allowable employee credit. An employee working in an enterprise zone will be entitled to a nonrefundable credit equal to 5 percent of wages paid for services performed within the enterprise zone, up to 1-1/2 times the FUTA wage base (currently $7,000). Thus, the current maximum credit will be 5 percent of $10,500, or $525. This credit will not be included in taxable income.

The tax credit will increase take-home pay to qualified employees who work in the zone. Such a benefit will be important to inducing workers to accept employment within the zones that may initially be somewhat undesirable places to work. For zones lasting between 21 and 24 years, the credit will phaseout during this period, declining by 25 percent per year.

C. Investment Tax Credit for Enterprise Zone Property.

As I mentioned earlier, the Federal tax incentives contain not only strong incentives for labor-intensive businesses, but also provide stimulus for capital investment in the zones through special investment tax credits and a capital gains exclusion.

With respect to tangible depreciable property used in the active conduct of a trade or business in an enterprise zone, a nonrefundable investment tax credit will be provided in addition to the regular investment tax credit. An additional 3-percent credit will be provided for property currently within the 3-year ACRS property class and an additional 5-percent credit will be available for all other depreciable tangible personal property. The 3- and 5-percent credits basically increase the regular investment tax credit by 50 percent. To be eligible for the credit, the personal property must be used predominately within the enterprise zone in a trade or business conducted in the zone. This will prevent the taking of the credit for highly mobile capital with only superficial connections to the zone.

With respect to real property, to encourage the development of commercial and industrial structures in zone areas, a 10-percent credit is provided for new construction and reconstruction of buildings in an enterprise zone after designation. The basis in real property will be reduced by the amount of the credit claimed.

The credits will apply only to capital investment made in a zone after it is so designated. Existing businesses in the zones will not receive any tax benefit for their past investment. These businesses will, however, be able to take the credit for all new investments whether to replace worn out capital currently in use or to increase capacity. Property that is sold or removed from an enterprise zone will be subject to a partial recapture of the credit equal to the percentage derived by dividing the number of years the property was used by the taxpayer by the life of the asset for earnings and profits purposes.

D. Capital Gains Exclusion.

The favorable tax treatment accorded capital gains within enterprise zones should stimulate investment in the zones by real estate developers and by entrepreneurs and venture capitalists seeking to start and build up new businesses. This should attract to the zones new, small businesses with substantial growth potential. More generally, the incentive should encourage capital investments within the zone areas.

Specifically, qualified enterprise zone capital gains will not be subject to tax. A qualified enterprise zone capital gain is defined as a long term capital gain from the sale of qualified property. Qualified property is tangible personal property and real property used by the taxpayer predominately in the active conduct of a trade or business in an enterprise zone, or it may be an interest in a corporation, partnership, or other entity, if for the 3 most recent taxable years of the entity ending before the date of disposition, the entity conducted a qualified business. A qualified business is an active trade or business conducted within an enterprise zone, with respect to which at least 80 percent of the gross receipts were attributable to such active conduct of a trade or business and substantially all the tangible assets of which are located within an enterprise zone.

Special rules are provided that are designed to curtail the potential for abuse in this area. For example, gain from the sale of an interest in a qualified business will not qualify for exclusion to the extent it is attributable to: (1) any property contributed to the business within the previous 12 months, (2) any interest owned by a qualified business in any other business that is not a qualified business, and (3) any other intangible property owned by the qualified business that was not created as part of a active trade or business within an enterprise zone after designation of the area as an enterprise zone.

These special capital gains provisions will continue to apply after zone designation lapses until the first time each item of otherwise qualified property was sold or exchanged. This would assure investors that they will be able to receive the benefit of this incentive and avoid a rush to sell zone property when the end of the zone period approaches.

E. Small Issue Industrial Development Bonds.

In addition to the additional investment tax credits and special rule for zone capital gain, preservation of the use of small issue industrial development bonds should also help small businesses obtain low-cost financing to begin or expand their ventures. At the present time, small issue IDB's are scheduled to sunset at the end of 1985. The bill will remove this sunset date for the entire period during which an area is designated as an enterprise zone.

F. Revenue Estimates.

Because we are not certain of when the 75 zones will be designated or their size and characteristics, the revenue estimates were based on a representative zone containing 7,000 employees. The estimates therefore can be expected to change as the zones are actually designated by HUD. Also, the revenue costs increase in future years as the number of zones and business activity within each zone increase. The projected revenue losses for the phasing in of the 75 zones over the next several years are:

Fiscal Years

($ billions)

1984	1985	1986	1987	1988
-.1	-.4	-.8	-1.1	-1.1

Conclusion

The enterprise zone program represents a fresh approach for dealing with the problems of economically distressed areas. Unlike the programs put forth in the past, enterprise zones will spur economic activity by removing one of the largest barriers to its growth -- excessive governmental regulation. We are confident that the total program contains the necessary ingredients to make it a complete success and I urge you to lend your support to our efforts.

The CHAIRMAN. Thank you, Bill.

Mr. Swain.

STATEMENT OF FRANK SWAIN, CHIEF COUNSEL FOR ADVOCACY, U.S. SMALL BUSINESS ADMINISTRATION

Mr. SWAIN. Thank you, Mr. Chairman.

It is my belief as Chief Counsel for Advocacy at the SBA that the small businesses of our nation will represent a major element in the enterprise zones and the success of the zones. As chief counsel, my responsibility at the Small Business Administration is to assess and analyze the impact of Federal policies on small businesses. As such, I don't have direct operating responsibility over the SBA programs and specific lending and grant programs, but we at the SBA are particularly interested and concerned that the Congress act expeditiously on the enterprise zone proposal.

Small business is becoming increasingly recognized as a major economic and political force. Small businesses have a tremendous record in terms of innovation of new products and processes and have a clearly documented and tremendous record in terms of hiring. When you are looking at job growth, you really have to look directly at the small business sector.

And what we are beginning to realize is that small business also has a very strong role to play in terms of worker training. Two out of three new workers get their first jobs with small firms, although of course many of those workers migrate on to larger firms.

In attempting to work with small businesses, we have paid particular attention to the various efforts that State governments have made on behalf of small business, and they have been very active indeed in the enterprise zone area. As the Chairman has indicated, I think some 16 States now have enacted some type of enterprise zone legislation, with various combinations of tax incentives, regulatory incentives and local financing programs.

We find that to be a very positive development indeed. One of the things we have attempted to do is to take a look at how those programs are working, as well as how the enterprise zone proposal might work for small firms in general.

One of the things that we have discovered is that we do think, and I would agree with Secretary Pierce, that we would expect small firms to use enterprise zones a great deal. Large firms just don't move very fast in comparison to small firms. They don't move in. They don't move out. When you take a look at employment within the so-called inner city areas, large firms don't hire; in fact, show a net employment decrease; small firms show a net employment increase.

The second thing that we have attempted to take a look at is taking two of the State proposals which have been enacted, specifically Connecticut and Florida, and seeing what difference the enterprise zone law made to the cash flow of a firm, because of course, for a small business that is of premier importance. The study examined the cash flow changes generated by the State programs alone in combination with the Federal tax incentives as they were proposed in last year's Senate bill.

What the results of the findings were is that Federal incentives have a far more substantial impact on cash flows than either of the State incentive packages over a ten-year analysis. In fact, the total amount of the Federal incentives were about four to five times the amount of the State incentives in both States studied, Connecticut and Florida.

However, none of the 24 cases—and we took as a model three different types of businesses: retailing, wholesaling and manufacturing, a large and a small business in each—none of the 24 cases analyzed can use these credits during the first year, assuming that they are a start-up business; and the manufacturer and wholesaler of both large and small businesses generally cannot use the federal credits until their third year of operation.

Also, the wage credit provisions of the Federal incentives do not have substantial impact on the cash flow of firms during their first several years of operation. This feature is due to the lack of or low tax liability experienced by these firms during the first years of operation, although these credits can be carried forward. These Federal incentives do have their greatest impact in the middle year, the third through the sixth years of a firm's existence.

Given the limitations of the study, it is difficult to generalize in an absolute sense, but we do believe that the incentives are of particular use to established firms expanding in enterprise zones rather than new firms, unless State and local governments attempt to pick up the slack and include some cash flow incentives in their proposals.

In addition, the majority of the benefits were not available to the firms during their first several years of operation because a new firm, concerned with surviving its initial years of operation, is likely to discount potential benefits earned but unavailable in these years.

The SBA advocacy office is researching the particular types and sizes of business that may be taking part in these zones. This has led us to some conclusions that small businesses have a particular concern, not only with cash flow but about something that Congress may not have any direct control over—I guess we are calling it infrastructure these days—generally the local delivery of goods and services, particularly such prosaic things as police and fire protection and garbage collection and so on, which are particularly important for small firms. We also think that the availability of job training facilities is particularly important to small firms.

Finally, let me just summarize and say that in the 2 years that I have had the responsibility to be the advocate for small business, talking with a lot of small businesses, there is a lot of genuine interest in the enterprise zone proposal. I don't think that you would have had 16 States enacting it if there weren't, and we would certainly recommend that the Congress act as quickly as possible.

Thank you, Mr. Chairman.

[The abstract and statement of Mr. Swain follow:]

ABSTRACT

The objective of this report is to provide the Small Business Administration (SBA) with a quantitative illustration and an analysis of the impacts of proposed and actual enterprise zone incentives on the cash flow positions of small businesses drawn from different industries. These incentives are being offered by several states (14 as of November 1982) and have been proposed at the federal level by the Reagan administration through legislation introduced in both the House of Representatives and the Senate. An underlying question concerning the state and (proposed) federal incentives is whether they provide a sufficient stream of benefits to attract both new and expanding businesses to enterprise zones.

In order to conduct this analysis, the Coopers & Lybrand proprietary enterprise zone tax impact model was applied to hypothetical firms constructed from aggregate industry data. The firms selected represented three industries (manufacturing, wholesale trade and retail trade); in addition, each firm was examined at two different assets levels. The impacts of enterprise zone incentives were illustrated by considering the tax liability and cash flow positions of each firm in two circumstances: If it operates outside of an enterprise zone, and if it operates in an enterprise zone. To provide a further basis for analysis, enterprise zone incentives from two different states were used, and their impacts were compared.

The enterprise zone incentives were found to provide cash flow benefits to all firms; however, the majority of the benefits were not available to the firms during their first several years of operation. It was also found that the federal benefits were far greater than those provided by either of the state enterprise zone incentives during a firm's first years of operation and the amount of state benefits actually available to a firm were found to be restricted by three main factors: the 'add back' provisions in the states' legislation; the fact that state tax rates are lower than federal tax rates; and the fact that any decrease in a firm's state tax liability leads to an increase in its federal tax liability.

The major conclusion drawn from the analysis conducted in this study is that the enterprise zone incentives will be of greater benefit to established firms expanding into enterprise zones than to new firms starting business in an enterprise zone. The new firm has to be concerned with surviving its itital years of operation and is likely to heavily discount potential benefits earned but unavailable in those years.

STATEMENT OF FRANK S. SWAIN, CHIEF COUNSEL FOR ADVOCACY, U.S. SMALL BUSINESS ADMINISTRATION

Mr. Chairman, I greatly appreciate your inviting me to testify at this important hearing concerning the Administration's Enterprise Zone proposal, S. 863. It is my firm belief that the small businesses of our nation will represent a major element for those Enterprise Zones which will be successful in local economic revitalization and job generation.

My testimony will cover the following topics: small businesses as a major force in our economy and as job creators, involvement of state and local governments with small business, specific Advocacy research on Enterprise Zones, and some concluding remarks.

Office of Advocacy

The Office of Advocacy was created within the Small Business Administration (SBA) under Public Law 94-305 in June 1976. As Chief Counsel for Advocacy, my responsibilities include representing the views and interests of small businesses before other federal agencies. I am also charged with monitoring the implementation of the Regulatory Flexibility Act (RFA), Public Law 96-354, to assure that small firms and small entities receive appropriate consideration in the regulatory process.

We are also statutorily mandated to develop a small business data base and to foster analytic information from which small business policy may be developed in a deliberate manner.

We also seek to provide information on small business to interested persons working at the state level. For example, we have held four annual conferences of state legislators on small business issues. State and local economic development is a central issue for these officials and our sessions on Enterprise Zones have drawn great interest.

Overview of Small Business and The Economy

Small business is becoming increasingly recognized as a major economic and political force. Researchers and policymakers alike are finding that small firms, if given the chance, can provide many of the solutions to our economic problems. For instance, the Nation's productivity over the past decade has been declining. While the recession has played its part, much of this decline has been caused by a long-term slow-down in the development of new products and methods of production. Technological developments generate new jobs and higher standards of living for all of us. A recent study, conducted for the Small Business Administration, has found that small business can supply the stimulus for renewed growth in productivity. This is particularly true in the hi-tech fields. The study cited small firms as our Nation's major innovators--creating two and a half times as many new and marketable innovations per employee as large firms.

A new law, effective this year, will enhance the job-creation potential of small business. The Small Business Innovation Research Act, which was passed by the Congress and signed into law by President Reagan in 1982, provides small firms with a vehicle to become more involved in government sponsored research and development. Now Federal agencies with R&D budgets in excess of $100 million (11 agencies) are setting aside specific portions of their funds to encourage small business participation in government projects. If these firms can be attracted to Enterprise Zones, their involvement may generate many new jobs there, bring new ideas into the marketplace, and enhance competition.

Another area where small business has contributed to our Nation's economic and social well-being is job training. Over 65 percent of new workers get their first jobs with small businesses -- that's 2 out of every 3 new workers. While some of these individuals may move on to higher paying jobs with larger firms, it should be realized that the costs incurred to initially train them are borne by small business. This training enables these workers to attain higher incomes and be productive members of the work force. The SBA estimates that training allows workers moving from small to large firms to increase their incomes by an average of 23 percent in the first year. On the down side, we estimate that small firms lose about 30,000 workers per year at an average training cost per worker of $5000. That loss equals $150 million per year for small firms. In spite of the large cost to small firms, they provide the most efficient means of training unskilled or low-skilled workers for entrance into the economic mainstream.

In addition to job training, small firms are a major source of job creation. Recent studies estimate that small firms create between 50 to 75 percent of new jobs.[1] This is clearly a significant growth in our economy. In the 1980s our nation must create jobs to employ our expanding work force. Most of these jobs must be created by the private sector -- small business will have a major role to play in this effort.

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[1] The Office of Advocacy, U.S. Small Business Administration, The State of Small Business: A Report of the President, (Washington, D.C.: U. S. Government Printing Office, March 1983), Chapter 3.

Finally, a recent Dun and Bradstreet survey shows that although small firms account for less than a sixth of all employment, they expect to do more than a quarter of all business hiring in 1983. The 5,000 firms surveyed anticipated a 2.7 percent increase in employment for the year. The average employment increase anticipated by firms with fewer than 20 employees is 4.3 percent while firms employing over 25,000 expect to increase employment by only 0.3 percent. Twenty-three percent of these large firms are predicting an employment decrease. The results of the survey are just another indication that small businesses will be leaders in the economic recovery.

State and local small business issues

Advocacy's role as a resource for the various states studying small business policies is centered around our Annual Conferences. Our Fourth Annual Conference for State and Local Officials on Small Business Initiatives was held in St. Louis, Missouri in December 1982. Over 400 legislators and officials from 43 states and U. S. territories gathered to address current small business legislative issues, including enterprise zones and economic development mechanisms.

The Office of Advocacy prepared an analysis of each State Enterprise Zone bill which had been passed as of the fall of 1982 for this Conference. This survey shows that many states have joined President Reagan's call for private sector initiatives, and direct community involvement in the redevelopment of blighted areas. The states are seeking ways to combine private and state funds with existing federal programs to achieve the maximum enhancement for employment and redevelopment in the zones. Partnerships have already begun between the federal government, the states, municipalities and the private sector.

For example, in the State of Maryland, the Maryland Industrial Land Act increased its loan limits for property acquisitions up to $2 million and 50 percent of property cost. The Maryland Industrial and Commercial Redevelopment Fund, a state Urban Development Action Grant (UDAG) program, increased it's loans and grants to any city or county; and, an Enterprise Zone Venture Capital Guarantee Fund was established to insure loans to firms in designated areas up to 100 percent.

In Illinois, the Illinois Industrial Development Authority is empowered to enter into venture capital agreements with business locating or expanding into the zones. While in Florida, the use of industrial revenue bonds as an incentive translates into lower borrowing costs and reduced debt service for total capital expenditures which may aggregate up to $20 million in cases where UDAG funds are provided by HUD to be used as part of the project financing package. The IRB however, may not exceed $10 million. Separately, Florida's County Redevelopment agencies may issue negotiable redevelopment revenue bonds and fund projects to improve distressed neighborhoods and entrepreneurial skills.

One conference participant on the State Economic Development Panel expressed what is happening at the state level. "...state governments are the laboratories right now in terms of new small business innovation, policies, projects and programs."

Research on Enterprise Zones

Part of our research efforts have been directed toward the role of small business in Enterprise Zones. How would new, existing and/or relocated small firms thrive in an Enterprise Zone type environment? Our findings point to the significance of small businesses in the economic revitalization of the inner cities. We think that state and local governments will find this research useful in designing their own proposals.

One research project prepared by Cambridge Systematics, Inc. examined the impact on small retail businesses of efforts to revitalize downtown commercial districts in six cities: Trenton, Madison, Memphis, Baltimore, New Orleans, Portland, and Boston. In each area, the revitalization efforts attempted to bring new activity to an existing retail district, rather than the construction of a new shopping facility.

Comparisons of the changes over time in business growth and composition within the revitalization zones suggest that large size stores grow less, enter revitalized areas less often, and exit less often than smaller stores. Additionally, revitalization had no significant impact on growth or exits of existing businesses, but did have a significant impact on increasing the rates of new store entry into the revitalized areas. Finally, in both the revitalization zones and comparison zones, the existing large independent stores consistently tended to show declines in employment size while the small independent stores showed increases.

Another research project was completed by Coopers and Lybrand, an international accounting and consulting firm. This report, entitled _The Impact of Enterprise Zone Tax Incentives on Selected Small Businesses_, examines the cash flow impacts of proposed Federal tax incentives as well as state incentives from two selected states.

This study applied a tax impact model to the financial data of hypothetical small businesses in three major industries--manufacturing, wholesale trade, and retail trade. Financial data for two size classes of small businesses were analyzed, firms with $0-1 million in assets and fewer than twenty employees and larger small firms with $1-10 million in assets and 20-50 employees. The effects of federal and state incentives were measured using provisions from the "Enterprise Zone Act of 1982" (Senate Bill #2298) and the sets of incentives enacted by the Connecticut and Florida legislatures.

The impacts of the incentives were illustrated by considering the tax liability and cash flow positions of each business under two conditions: as if the business operated outside of an enterprise zone and as if the business operated in an Enterprise Zone. Each of the sample firms was assumed to have sufficient capital available to fund expansions without recourse to the credit market. A total of 24 cases were examined, twelve for each set of state incentives.

Some of the results of this research effort show that federal incentives have a far more substantial impact on cash flows than either of the state incentive packages over the ten years analyzed. However, none of the 24 cases analyzed can use these credits during the first year, and the manufacturer and wholesaler (of both size classifications) generally cannot use the federal credits until their third year of operation. Also, the "wage credit" provisions of the federal incentives do not have substantial impact on the cash flow of firms during their first several years of operation. This feature is due both to the lack of (or the low) tax liability experienced by these firms during their first years of operation although these credits can be carried forward. These incentives do have their greatest impact during the third to sixth year of a firm's existence.

The ability to generalize from the results of this study is limited. Given these limitations, a major conclusion drawn from the analysis conducted in this study is that the enterprise zone incentives may be of greater benefit to established firms expanding into enterprise zones, unless state and local governments include some cash flow incentives in their proposals. In addition, the majority of the benefits were not available to the firms during their first several years of operation. The new firm has to be concerned with surviving its initial years of operation and is likely to heavily discount potential benefits earned but unavailable in those years.

A study currently underway is an extension of the project on revitalization. This current study by Cambridge Systematics Inc., examines the structure of economic growth and decline within six areas that are potential candidate Enterprise Zones: Boston, Hartford, St. Louis, Cleveland, New Orleans, and Denver. Since we do not know which small firms are likely to participate in Enterprise Zones, the focus of the study is to identify the types and sizes of businesses which are most likely to locate and succeed in these areas. The identification process is expected to lead to an assessment of the opportunities for development of small, job-generating businesses that can provide applicable employment for nearby residents in areas of high unemployment.

Preliminary findings suggest that the level of infrastructure improvements will attract specific types of new industries to Enterprise Zones. Light manufacturing, trade, and services have relatively low requirements for utilities and land requirements and, therefore, are more likely to be compatible with inner city areas than are heavy industries unless large investments in infrastructure are made by the local governments. Infrastructure requirements also influence relocations and expansions since firms often bypass regional decision-making and begin their location search on the local level. Upon its completion, we will forward the results of this report to the Committee.

Conclusion

Mr. Chairman, I have sought to establish, that new, existing and relocated small businesses operating within the geographic boundaries of a designated enterprise zone will represent a vital element for its success. Small businesses are key to the economic health of the area and to the new jobs which must be generated for the unemployed residents of the area.

In this regard, it may be beneficial for me to emphasize the important role small business is to play in any enterprise zone legislation.

An important additional issue deals with the so-called "infrastructure" problem. The ability of small firms to be attracted to a zone will depend on how the local administrative authorities handle the providing of important governmental services such as transportation, fire, police, garbage, etc. Without access to these services at reasonable costs, many small firms will be dissuaded from establishing their operations in a zone area.

Another consideration reflects comments expressed to me by small firms of their need to employ properly skilled individuals who can be trained for a job for a period of time without having such persons quickly shift to other employment after receiving their initial training and skills development. Thus, the availability of effective technical and semi-skilled job training facilities for zone residents is needed and should be recognized in the proposals of state and local governments.

As Chief Counsel for Advocacy, I have had numerous opportunities to review Federal and State administrative labyrinths that have been very costly for small firms and have kept them from achieving their business goals in a timely manner. In view of the numerous, federal, state, and local bureaucracies that will be involved with enterprise zone implementation and procedures, I urge that reporting and administrative requirements be kept as simple as possible.

Thank you very much for inviting me to participate before your Committee. I hope the Committee will act favorably and promptly on the Administration's Enterprise Zone proposal. I would be pleased to reply to any questions the Committee may have.

References:

1. Coopers and Lybrand Economic Studies Group. The Impact of Enterprise Zone Tax Incentives On Selected Small Businesses. This report was prepared for the Office of Advocacy, U. S. Small Business Administration, November 1982.

2. Cambridge Systematics, Inc. Impacts of Downtown Revitalization Projects on Small Business. This report was prepared for the Office of Advocacy, U. S. Small Business Administration, under contract SB-1A-00018-01-0, September 1981.

3. Enterprise Zone Legislation: State by State Analysis. Office of Advocacy, U. S. Small Business Administration, October 1982.

The **Chairman**. Thank you very much.

Senator Long?

Senator **Long**. What is your revenue estimate of the cost of what you are advocating?

Mr. **McKee**. The total revenue estimate for the 5-year period I believe is $3.3 billion.

Senator **Long**. $3.3 billion for 5 years?

Mr. **McKee**. Let me get that for you exactly, sir.

[Pause.]

Mr. **McKee**. I have it by year. It is $87 million in 1984, $400 in 1985, $765 million for 1986, $1.058 billion for 1987, and $1.142 billion in 1988. I believe that adds up to about $3.3 billion.

Senator **Long**. Basically what you are recommending is that we use tax incentives. Some want to call it tax expenditures, but whatever you call it, you are urging that we use the tax laws and tax incentives to help develop these enterprise zones and provide economic activity and jobs, I take it?

Mr. **McKee**. That is correct.

Senator **Long**. I am pleased to see you recommending that kind of thing. I think that more and more we are coming into a position with our tax policy that we are ready to use our tax laws constructively. You should pay your full taxes if you don't use your money in ways that the Government thoroughly approves. But if you invest it and put it to work in ways that our society very thoroughly supports, you get much more favorable tax treatment.

Mr. **McKee**. That is correct.

Senator **Long**. One advantage of your approach here, compared to the appropriations process, is that if we put this into effect, people know that they are going to get it over a period of years. How many years can they count on under this legislation?

Mr. **McKee**. The tax provisions, as long as the zone designation stays in effect, is a 20-year program with a 4-year phaseout, Senator. So it is a 24-year total program, as long as the zone designation stays in effect.

The Secretary of HUD can remove zone designation if the State or local government fails to live up to its end of the bargain. It is designed to be a program that involves not only Federal initiatives but State and local initiatives, as Secretary Pierce said, in a partnership approach.

Senator **Long**. But under this program, if people want to participate in it, they continue to get the benefit of it until such time as Congress acts to say they don't. Generally speaking, that is what it means, isn't that right?

Mr. **McKee**. Correct.

Senator **Long**. Now the alternative way, to go by the annual appropriations process, is that they get it if Congress acts. In other words, each year you go back to Congress. Congress might appropriate the money and then again they might not. Someone might have a limitation, an amendment, a condition, a whereas, one thing and another, so that by the time the Congress gets through, you may get it and then again you may not.

The approach you are recommending here of using the tax system would have the advantage that the people who want to engage in it at least can have some peace of mind that this will continue unless the Congress finds that it is just not a good idea and wants to get out of the program.

Mr. McKee. That is correct, Senator. The idea is simply to reduce governmental involvement that impedes private activity and simply remove those burdens from enterprise zone activity. Obviously, the tax burden, or as an economist would say, the tax wedge, reduces economic activity. It is a cost of having the tax system. And what we are trying to do is reduce the tax wedge in the enterprise zone context.

Senator Long. One thing that bothers me about any Federal program, particularly a new program, is that so many times one administration starts something and they get going on it as though they are going to do something with it, then the next administration comes in and doesn't like it so they won't fund it.

Frankly, some of Mr. Carter's programs are dying on the vine right now because the successive administration doesn't see fit to fund it. That is not peculiar to this administration. It tends to happen also with other administrations. They come in and tend to look with disdain on what the predecessor was doing and so the program dies.

This matter you are proposing I think would have some continuity if we want to go forward with it. It sounds like that.

Mr. McKee. We agree.

The Chairman. Senator Bradley?

Senator Bradley. Thank you, Mr. Chairman.

I would ask Mr. McKee if I put a building in an urban enterprise zone and sold it a year and a half later, how would the capital gains on that transaction be treated relative to a building right outside the urban enterprise zone?

Mr. McKee. The capital gain incurred in the year and a half period that you had the building in the enterprise zone would be exempt from Federal tax.

Senator Bradley. No tax at all?

Mr. McKee. No tax, whereas the building that was outside the enterprise zone would be subject to the normal capital gains provisions that are now in the code.

Senator Bradley. And is there a length of time, 12 months is it, that I have to——

Mr. McKee. Has to comply with the normal capital gain definitions, that is right.

Senator Bradley. You mean the normal definition for——

Mr. McKee. Capital asset for long-term capital gain.

Senator Bradley. OK. In your testimony, Mr. Swain, you talk about the infrastructure problem and you say:

> The ability of small firms to be attracted to the zone will depend on how the local administrative authorities handle the providing of important governmental services such as transportation, fire, police, garbage, et cetera. Without access to these services at reasonable cost, many small firms will be dissuaded from establishing their operations in a zone area.

A lot of the communities that are targeted for urban enterprise zones have very serious tax base problems and at this time can't begin to fund adequately these services. So what is your answer as to how we can begin to get those infrastructure services funded at an adequate level, other than raising the local property tax and further eroding the tax base by having other people move out of the community?

Mr. **Swain**. I am not an expert, Senator, on municipal finance. I do believe that there are a number of options which might be considered to make sure that there is delivery of normal infrastructure services, particularly to a zone.

If, for instance, one is seeking to attempt to attract a manufacturing facility to a zone and you want to make sure that you have waste disposal that is both regular and dependable and in keeping with the environmental laws, I would think at this juncture you would be interested in contracting with private firms.

Maybe some moneys would be available through State programs or through special programs that would not be available given the normal urban tax base.

In fact, in the legislative proposal, the clear suggestion is that State and local authorities consider contracting out to private firms where there might be some efficiencies to be gained that are not there presently. That is certainly not the ultimate answer, but I think local authorities need to show considerable imagination. They have solved the problems in some areas, I know.

Senator **Bradley**. So it is your idea that these municipal services would be better rendered by private enterprise?

Mr. **Swain**. I would say that the question ought to be asked in every case and the presumption ought to be that there ought to be some costing out to determine if they could be rendered by private enterprises.

Senator **Bradley**. Well I must say, I am a little doubtful about having private police forces surrounding the urban enterprise zone. I think that the problem that you point to in your testimony is one last year that we had a panel of mayors here and the mayor of Baltimore raised this issue, that if you don't have adequate municipal services, that this is not going to work as well as if you have adequate municipal services.

I think that we ought to give some consideration in this package to considering some way to try to assure an adequate funding stream for those areas.

Now in previous years we had a distress mechanism that was part of an aid program to distressed areas that went to municipal governments. That worked for a while and then we lost it. I think frankly we ought to give some consideration to that or we are going to have these jewels that are going to be there, if it works, for a couple of years and then it is going to be vacant and it is going to be a living example of another failure of Government to come to grips with these very serious problems in the urban areas.

It is like the situation with some public housing projects that are monuments both to government's aspirations and to the failure to realize those aspirations.

So I think that while this is an important program, we have to take into account the municipal finances of some of these areas.

The **Chairman**. Thank you, Senator Bradley.

I have no questions except that I want to follow up. What we don't want to create are little havens here and there. We have been through the drug company efforts and how they put patents in Puerto Rico and avoid all kinds of taxes.

Now is the Treasury looking into those little goodies so that we won't be creating some little island or islands around the country for companies to move in with a little storefront and reap a lot of tax benefits from activities carried on in some other place?

Mr. McKEE. We have tried very carefully to tailor the package to have the right balance between incentives for labor and capital. For example, the reason we opposed the expensing of an investment in the zone is it would lead to exactly that kind of abuse. You would have much capital for relatively passive assets, as Secretary Pierce said. The paintings that are sold on Fifth Avenue would be warehoused in the enterprise zone, so that they would have a very low tax rate.

In order to avoid that, we have tried to tailor the incentives such that that will not happen.

The CHAIRMAN. That is probably one area, but I imagine there are 15 or 20 others that somebody will think of if we don't correct them in advance.

Mr. McKEE. We have tried to do that. For example, in the capital gain area, it is only the capital gain that occurs while the enterprise zone activity is underway The bill is also structured so that only the gain—for example, if you have stock in a company that has an enterprise zone activity but also has some unrelated activity, you only get exemption from capital gain to the extent that it is attributable to the enterprise zone part, and not to the unrelated part. We have tried to work pretty hard on that.

The CHAIRMAN. Thank you very much, and we will be working with both you and Mr. Swain. We appreciate your testimony. Your entire statements will be made a part of the record.

Now I don't see Senator Boschwitz. He is still on his way. I think he must be coming from Minnesota.

I would like to call now the Honorable George Voinovich, mayor of Cleveland, accompanied by Russ Geuther of McDonald and Co., Cleveland, Ohio. And then if it is all right with the mayor of Cleveland, I would like to have him joined by the Honorable Doug DeGood, mayor of Toledo, on behalf of the city and of the National League of Cities, accompanied by George Haigh, chairman of the Toledo Economic Planning Council and Reuben Bumpus, president of the R. F. Bumpus Co. in Toledo.

And then finally we have another mayor here. I would like for John Smith who is mayor of Pritchard, Ala. on behalf of the National Conference of Black Mayors, to come forward. We might have that array of mayors and whoever they may have with them at the table at the same time. So if you could all come forward, we would appreciate it.

George, do you want to start off? You may want to introduce those who are accompanying you, and I would say this, that your entire statements will be made a part of the record. We hope that you might give us some insight on activities in your areas and generally that you support what we are trying to do.

STATEMENT OF HON. GEORGE VOINOVICH, MAYOR, CLEVELAND, OHIO, ACCOMPANIED BY RUSSELL GEUTHER, McDONALD & CO., CLEVELAND, OHIO

Mr. VOINOVICH. Thank you.

I am here this morning, Mr. Chairman, as mayor of the city of Cleveland and also as second vice president of the National League of Cities. I have with me Mr. Russell Geuther, who I will introduce later, from our private sector in Cleveland.

We would like two documents to be included in the record. Both have been supplied to your staff. One is an extract from the National Municipal Policy, which discusses enterprise zone. That is the National League of Cities municipal policy, with some recommended improvements to the bill. Also, a booklet called target area investment program, which is put together by our Cleveland private sector in conjunction with the city that is the best evidence of the fact that even the talk of this piece of legislation has caused a lot to happen, at least in the city of Cleveland and I am sure in many other cities throughout the country.

The CHAIRMAN. They will be accepted. They will not be reprinted in the record, but we will receive them.

[The materials referred to follow:]

TARGET AREA INVESTMENT PROGRAM

Cleveland, Ohio

March, 1983

Identifying Objectives

A concerned group in the City of Cleveland is working to shape an economic development strategy which will create a climate for investment opportunity and substantial redevelopment in a targeted area of the City.

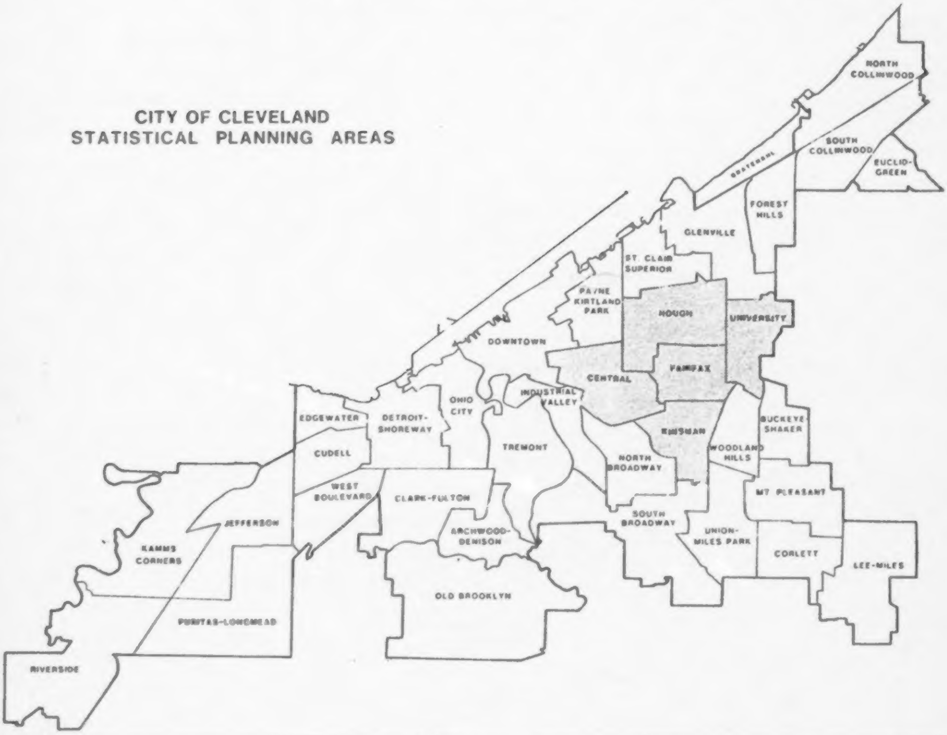
Like many other American cities, Cleveland embarked on this project so it can respond quickly and effectively to anticipated federal "enterprise zone" legislation, first introduced in Congress in 1980.

Cleveland's Mayor, George V. Voinovich, strongly supported the enterprise zone concept and made it a high priority for his Department of Economic Development. After studying the legislation's requirements, the Department selected five from the 35 statistical planning areas in the City, as defined by census tract aggregations.

The area chosen is the most distressed in the City, considering such criteria as population loss, unemployment, low income families and housing demolition. In the last decade, the population dropped 33 percent; since 1960, 38 percent of the housing units have been torn down; today, 37 percent of the families receive public assistance.

Other factors, however, make that area a target of opportunity. The land lies between two major growth poles in Cleveland -- Downtown and University Circle. The Cleveland Clinic, currently undergoing a major expansion, lies along the corridor connecting those two poles. On either side of the corridor lie neighborhoods where strong grass roots efforts have maintained the dignity of life, despite surrounding blight. Large tracts of vacant and City-owned land can be developed without displacing residents. Many businesses thrive there.

The area graphically demonstrates what has happened to the City since World War II. In 1947, almost a quarter of a million manufacturing jobs could be found within the borders of Cleveland, then one of the strongest, most diversified



CITY OF CLEVELAND
STATISTICAL PLANNING AREAS

NORTH COLLINWOOD
SOUTH COLLINWOOD
EUCLID-GREEN
BRATENAHL
FOREST HILLS
GLENVILLE
ST. CLAIR SUPERIOR
PAYNE KIRTLAND PARK
HOUGH
UNIVERSITY
DOWNTOWN
FAIRFAX
CENTRAL
INDUSTRIAL VALLEY
OHIO CITY
EDGEWATER
DETROIT-SHOREWAY
KINSMAN
BUCKEYE-SHAKER
WOODLAND HILLS
CUDELL
TREMONT
NORTH BROADWAY
WEST BOULEVARD
CLARK-FULTON
MT PLEASANT
JEFFERSON
SOUTH BROADWAY
ARCHWOOD-DENISON
UNION-MILES PARK
KAMMS CORNERS
CORLETT
LEE-MILES
OLD BROOKLYN
PURITAS-LONGMEAD
RIVERSIDE

industrial cities in the world. Its economy revolved around steel, iron, railroading, machine tools, illumination, automobile and truck manufacturing.

Today, manufacturing employment has been cut in half -- to under 110,000 -- by plant closings, migration to suburban and sunbelt locations, labor-saving equipment and the lack of new investment.

Moreover, Cleveland's default on its debt obligations, under a previous City administration, inhibited its ability to borrow money to upgrade aging capital facilities. Few federal grant funds or state revenue funds were channeled into leveraging job-creating private investments.

Despite that history of decline and neglect, the citizens of Cleveland, with the support and cooperation of its business leadership, are committed to improving our economic well-being. A turn-around can be achieved only through retention and expansion of existing enterprises, together with the nurturing and support of new businesses. While the future employment base is not likely to have a high manufacturing component, there is steady growth in medical services, service occupations and new technologies which will lead to a stable, more resilient City.

To Mayor Voinovich, the enterprise zone concept is an excellent vehicle for revitalization. By creating jobs and enhancing neighborhoods, the deteriorated areas can be made productive, livable, desirable once again.

The Mayor, and the volunteers who have already begun working on the Target Area Investment Program, recognize that there are no short-term solutions to the complex problems. There is a need for a comprehensive, unified, local effort to concentrate local, state and federal government programs. The program is designed to rely primarily on incentives; it will provide a forum for both the public and private sectors to negotiate and resolve problems.

Forming Committees

Initially, the Mayor's office sought support and acceptance of a Target Area Investment Program from many groups and individuals, both in the public and private sectors: City Council, community residents, neighborhood organizations and private citizens -- pastors, area businessmen and any who had expressed interest in an economic development effort.

Cooperation was enlisted from organizations such as Cleveland Tomorrow, The Greater Cleveland Growth Association, the Greater Cleveland Roundtable, the Community Capital Investment Strategy, University Circle, Inc., Hough Area Development Corporation and many others.

There were two major results of those early contacts. A list was drawn up of 20 specific objectives which must be met if the plan for investment and redevelopment could hope for success; also, a list was developed of more than 100 volunteers who were willing to serve on planning groups.

The following groups were established, composed of City department directors, representatives of City Council, residents of the proposed redevelopment area, and professionals:

ECONOMIC DEVELOPMENT
COMMUNITY DEVELOPMENT
PHYSICAL DEVELOPMENT
INSTITUTIONAL FRAMEWORK
PUBLIC INFORMATION AND MARKETING
LEGISLATIVE REVIEW AND DEVELOPMENT

Finally, a Steering Committee coordinates all six groups, monitoring their efforts and resolving differences. The Steering Committee is formed of leaders from each of the six planning groups, and certain key individuals. It is co-chaired by Reverend Otis Moss and Russell Geuther, a loaned executive from McDonald & Company, who coordinates the Target Area Investment Program, and Mayor George V. Voinovich and Council President George L. Forbes.

OBJECTIVES OF THE COMMITTEES:

ECONOMIC DEVELOPMENT PLANNING GROUP

- to devise a strategy to retain, generate and attract business for the targeted area;
- to identify a compatible set of incentives and target industries suitable for the area;
- to develop ways to meet employment needs of existing and potential employers, emphasizing a plan for hiring area residents;
- to develop opportunities for minority businesses in the area.

PHYSICAL DEVELOPMENT PLANNING GROUP

- to develop an overall plan for physical improvements, drawing up a schematic map as a guide for investors and developers;
- to identify improvements necessary to the infrastructure and in the delivery of utility services to support the planned physical development.

COMMUNITY DEVELOPMENT PLANNING GROUP

- to plan ways to ensure local resident and business participation in the program;
- to identify housing needs and develop a basic housing and commercial revitalization strategy;
- to suggest methods for improved service delivery in the area -- including the possibility for alternative methods to deliver traditional public services.

INSTITUTIONAL FRAMEWORK PLANNING GROUP

- to study all possible options and make recommendations for a management organization capable of carrying out the Target Area Investment Program.

LEGISLATIVE REVIEW & DEVELOPMENT SUPPORT GROUP

- to review existing legislation relating to the program;
- to provide legal assistance to the planning groups;
- to develop legislation and testimony when necessary.

PUBLIC INFORMATION & MARKETING SUPPORT GROUP

- to set up a plan for communicating the goals of the program;
- to prepare a marketing plan which shows the area as a good place to live and do business.

City of

TARGET AREA INVE

May '82

Identifying Objectives

- Lay groundwork
- Define interest
- Set parameters
- Establish timetable
- Secure support

August '82

Forming Committees

- Private Sector
- City Administration
- City Council
- Neighborhood Residents
- Program Experts

Sept. '82

Developing the Program

- Build data base
- Analyze findings
- Suggest options
- Make recommendations

Cleveland

STMENT PROGRAM

April '83

Reviewing the Program

- Test Program feasibility
- Identify strengths
- Outline action agenda

June '83

Securing Resources

- Reach agreement on public & private resources to implement the Program

Jan. '84

Implementing the Program

- Increase employment opportunities
- Increase the tax base
- Revitalize a targeted area

Developing the Program

All too often, grand plans are announced with overwhelming fanfare and then quickly abandoned, covered by the dust of the announcement of yet another great idea. So the Mayor made no public announcement of the work begun on the Target Area Investment Program, preferring to allow the various groups enough time to complete careful groundwork.

Beginning in summer, 1982, each committee searched for information. Some of their questions eventually led to specific recommendations; others only generated information which became part of a data base for further inquiries.

Of primary importance was the question, what kind of incentives will make the area more attractive to business? Would investors be attracted if parcels of land were assembled? Was it advisable to consider new land use patterns? Where could we find investment capital? Who could provide financing? What are the possibilities for tax relief, or regulatory relief? Was it simply a matter of more efficient processing of permits and licenses? Could this be done by an ombudsman in City Hall to help business people?

There were other concerns -- the need for customized training programs, the need for daycare facilities, the need for more and more visible security, the cost of a clean and attractive appearance, adequate utilities and public services.

To learn about what incentives would attract investment, a telephone survey of 1,000 business people was conducted, followed by an in-depth interview with 60 of the respondents. Even after identifying a group of industries which might be expected to grow in the next two decades, the committee members had to ask what kind of facilities might be built to attract them and how could these facilities be included in a broader area land use plan.

The feasibility of rehabilitating old housing stock, as compared with the encouragement of new construction, is a familiar dilemma to older cities. What current community residents want is critical; therefore, committee members carefully planned ways to secure citizen input during the program's planning and implementation stages. In addition, a survey was made of 125 organizations and institutions serving the nearby area to learn about their projects and to ensure a program responsive to their needs and coordinated with their plans.

By the end of March, 1983, the preliminary investigative work will be completed. The results will be incorporated into a draft revitalization report which will include a comprehensive data base and inventory of activities in the target area.

The report will outline priorities for the projects and list actions required from the various government levels and the private sector. In some cases, the committees will itemize project costs, and recommend possible sources for the necessary funds.

The next step, after compilation of the committee draft reports, is a review.

Reviewing the Program

In June, the Urban Land Institute (ULI) will send nine of its members to Cleveland to conduct an intensive one-week feasibility test of the plan.

The ULI Panel Advisory Service is comprised of nationally-recognized development authorities who can point out the strengths and weaknesses of the plan, and offer judgement about the proposed course of action. These experts will examine the estimates of the resources needed and the requirements for implementation.

The Steering Committee is working closely with the staff of the Urban Land Institute to structure with great care a series of questions which the panel will answer about the plan. The final report of the panel will be delivered to the Steering Committee during a public meeting on the last day of their visit. The Steering Committee will incorporate desired changes into the final redevelopment report.

The ULI, an independent organization, conducts research and interprets current land use trends as they relate to changing economic, social and civic needs of our society. Established in 1936 to disseminate information on the best and most efficent use and development of land, the ULI prefers to minimize theoretical discussions and apply a "hands-on" approach to analysis.

Members include land developers, builders, architects, city planners, investors, planning and renewal agencies, financial institutions and others interested in land use. They help each other to implement economically feasible projects by critiquing ideas and plans.

The ULI approach to development has proved so successful that more than 100 communities have taken advantage of its Panel Service Program. Each panelist serves without personal renumeration during the intensive one-week feasibility test.

The ULI panel members will study all Target Area Investment program committee reports prior to their on-site visit.

During the week in Cleveland, the ULI panel will conduct a briefing session the first day, to discuss problems and questions with the Target Area Investment Program committee members and concerned local officials.

Next, a series of interviews, conferences with local authorities and detailed field inspections will give the panel insight into conditions and problems; the panel chairman will assign specific issues to teams, depending on the expertise of the team members.

Executive sessions in the following days of the study will allow panelists to tie together findings and shape their conclusions into a final report.

On the last day, the panel will present its conclusions and recommendations. This presentation is followed by an open discussion of the report during a question-and-answer session, open to the public.

Approximately two months after the final report, a written report will be submitted to the City which sets out in detail the panel findings; also, members will be available to expand or elaborate on recommendations.

Securing Resources

After the plan has been revised, the next step -- probably the most critical of all -- is to secure commitments for resources to make redevelopment a reality.

The breadth and scope of this program is such that the combined impact will be greater than the sum of the separate projects undertaken. At the same time, there is great potential for conflict among competing interest groups in an era of scarce resources. Disagreement may arise over issues such as: Who benefits from the incentives? Will residents or businesses be displaced? Who will be hired for the jobs? What entity should monitor capital expenditure for the upgrading of utilities and the infrastructure?

All parties involved must approve the plan for final implementation of the program. A mechanism must be put in place for fair consideration of the concerns of the community, businesses and City, State and Federal representatives before decisions can be made on investing both public and private resources.

That mechanism is the Negotiated Investment Strategy (NIS) process, developed by the Urban Affairs Division of the Charles F. Kettering Foundation and first used in several midwestern test cities during 1979 and 1980. The NIS process provides a forum wherein participants from the public and private sectors and from community-based organizations can resolve issues and agree on a strategy for investment in the targeted area.

The NIS process involves an impartial mediator, negotiating teams who carry to the table their own agendas, and give-and-take during face-to-face negotiating sessions. Of vital importance to the success of these negotiations is the impartial mediator who can manage the sessions and keep the teams talking until final agreement is reached. A final document, reflecting those agreements, is signed by all participants, thus assuring their full commitment to the plan.

The agreement of all principals involved promises optimal return on the investment of public and private resources. Even as implementation begins, conditions may change; there is provision for re-negotiation as the need arises.

Implementing the Program

While most of the decisions about responsibilities and resources to implement the program will be made during the negotiating process, other decisions await legislative initiative, currently under consideration at federal, state and local levels. National and regional economic conditions also will play a role in final decisions on implementation.

The overriding goals of the Target Area Investment Program are to:

- increase employment opportunities;
- increase the tax base;
- revitalize a targeted area.

It is an ambitious program, requiring many years and a steadfast commitment to complete.

Some objectives will be met more easily and more fully than others, and some portions of the target area will be revitalized more quickly than others. Monitoring systems, now being designed, will measure the impact of various activities and incentives associated with the program.

We hope that the different aspects of this program will be recognized as successful pilot projects useful for application throughout the City.

Mr. VOINOVICH. I think you know about the National League of Cities and the fact that we represent some 1,500 cities throughout the country and we have 1,000 direct members.

I am pleased to emphasize that——

Senator LONG. Did you say 1,500 or 15,000, Mr. Mayor?

Mr. VOINOVICH. 15,000.

The NLC is a strong supporter of the enterprise zone concept as a public-private effort to stimulate employment and economic growth in areas of poverty and high unemployment. We agree with the eligibility and designation requirements of the legislation.

We would like to call to your attention that we believe that a State legislature or whoever is going to decide on the State level should not be able to veto an enterprise zone designation. We think that HUD ought to be able to do that, though we want to emphasize that the requirement that states participate in the program, as far as incentives, is absolutely essential if this is going to be successful.

The NLC approves of the basic thrust of providing tax incentives to stimulate employment of disadvantaged workers and for economic development, and we recommend that a provision be added so that within general guidelines, the local government can fix a required level of employment of disadvantaged persons to make a zone employer eligible. We think that that is a local decision that ought to be made in terms of what the employment ought to be.

We also call to your attention that the tax credits in the bill are nonrefundable. I think all of you know that front-end cash is very important to new businesses, and it would be nice if the credits provided in the bill were refundable, though from talking to some of our folks in the Cleveland area we think that new businesses can receive financing if you get a commitment from your private sector banking and savings and loan industry to the zone. And that is one of the things that we have folded into our proposal.

Related Federal programs. We think the enterprise zone will be effective if and only if it operates in conjunction with other federally supported programs. We want to make it very clear that we need the EDA public works grants for infrastructure. We need our UDAG grants for capitalization. We need our job training programs, particularly the Job Partnership Act which you have recently passed.

All of these programs are needed to have a successful enterprise zone program.

These comments that I have just made have been on behalf of the National League of Cities, and now I would like to quickly reference our experience in the city of Cleveland.

First of all, Mr. Chairman and members of the committee, I have lived with this legislation for 3 years. I spent a lot of time with Mr. Kemp and Mr. Garcia. I was chairman of the National League of Cities Task Force on Enterprise Zones. There has been a lot of talk, conferences, seminars and what have you on enterprise zones for the last several years.

I think that you have a good piece of legislation. I think now is the time to get it passed in the Senate so that we can go over and lobby it in the House. Its time is overdue.

I would like to point out also that enterprise zone incentives alone might not create jobs in distressed inner cities of America, but this is very important. The course of action necessary as a part of the enterprise zone application requires cities to go through a thoughtful process to address their own particular needs. It allows for differences in city capacity and economic conditions. It is not one of these things that is just legislated down from Washington and says this is the way you are going to do it. It gives us a lot of options on the local level.

This is another important thing. Anticipation of enterprise zone legislation has caused hundreds of distressed communities across the country to discover a new approach to economic development with emphasis on the public-private partnership. When I spoke to Dan Rostenkowski over in the House trying to get his support, I said when is it that you can remember that you got the city, the State, the Federal Government, the private sector, organized labor, and neighborhood organizations at the table talking about economic development in a community? For the most part it has been Federal programs, but not very much participation from the State or from local government or from the private sector.

And Mr. Geuther, who I have here today, will go through this little effort that we put together in Cleveland. It is a manifestation that that is the most positive part of this legislation in that it causes activity on the local level and gets a lot of folks together that heretofore haven't gotten together for purposes of economic development.

Since my time is up, I will now introduce Mr. Geuther, who will outline for you just what the anticipation of an enterprise zone piece of legislation has created in the city of Cleveland.

The CHAIRMAN. Mr. Geuther.

Mr. GEUTHER. Mr. Chairman, members of the committee, I am pleased to be here to testify in support of this enterprise zone legislation. Since last May, I have had the unique opportunity to work with Mayor Voinovich as a liaison between the business community and his office to coordinate Cleveland's enterprise zone program.

For the last 10 years, I have been in the business of financing business expansions. Before that, I worked with chambers of commerce across the Nation for 21 years. This experience with intergovernmental relations and understanding of the bottom line I believe, Mr. Chairman, gives me a balanced view of what kind of business response can honestly be expected to governmental incentives.

I would like to explain some of the concerns that I felt when I began to understand the complexity of the assignment that the mayor had given me. The goals of the enterprise zone program are indeed admirable and have been supported by a broad range of citizens and business people.

But as I began to understand the difficulties the city has in retaining and attracting investment, and I began to recognize the powerful trend that we are trying to reverse, I knew that the Federal enterprise zone incentives would not be enough, standing alone. However, the local course of action that is required by the enterprise zone program is an opportunity to encourage the cooperation that the mayor spoke of with all levels of government, the private sector, local residents and community organizations, and to secure resources and commitments necessary for a successful program.

A private business establishes goals and objectives and then carefully structures its activities to invest its resources according to the strategy. In the same way, a city must also create a strategy for investing its resources to attract businesses and create jobs.

From my perspective, there are several essential elements to an economic development strategy: land; a trained, competitive labor force; a good business climate; and capital. I might add, Mr. Chairman, that I believe capital will be available if we have the first three items—land, the trained competitive labor force and a good business climate, because then you have a good loan. After that, taxation and regulation make a marginal but often decisive difference in location decision.

I might also add in here that in our interview of businesses that were in the potential zone, the tax and regulatory reliefs and incentives are greater in the retention of business than they are in the securing of new business.

I would like to do two things today: Spend a few minutes describing the process we are using in Cleveland to develop our enterprise zone strategy or our course of action, and then to share some of our findings about what incentives must be a part of our strategy.

In the first phase of the program, we identified the boundaries of the planning area and the individuals and the organizations interested in participating. We enlisted the cooperation from the private sector, the churches, several development corporations, and neighborhood groups. As a result of those early contacts, we have 20 specific objectives that were outlined and had to be addressed if a plan for investment and redevelopment could hope to succeed.

We also identified individuals who were willing to serve on committees. We then formed the committees. The objectives were organized into groups and the committees were formed to meet those objectives. The committees were made up of private sector leaders, city administration, city council members, neighborhood residents, and program experts, all who volunteered their talents to this program.

The committees were economic development, community development, physical development, management, public information and legislation. They met and worked programs and began to address their objectives.

Our program development area began last summer, where each committee searched for information. Some of their questions led them to specific recommendations. Others only generated information which has become part of our data base for further inquiry. In all cases, the approach was to start with a firm foundation and not building on a second floor.

One of our problems with economic development, and I might point out that since I have been in Cleveland in 1968 to date, we have announced 38 new hotels and built 1—it takes a little time to build that foundation, and that is the sort of thing that this legislation that you are talking about today forces us to do or provides us an opportunity to do.

Our next step was to review the program that we put together, and we have engaged the Urban Land Institute to conduct a panel advisory review of our enterprise zone area and program. They will be doing this the first week of June. This review provides us with what we call a midcourse correction, so that we can incorporate the ideas of people who are involved in economic development by putting their money into projects into our final strategy.

Then we have moved into the securing of the resource commitment through the process called a negotiated investment strategy, where we use this in order to secure agreements from various levels of government, the private sector, and community residents. We use a neutral mediator to resolve differences, to get agreement to issues, and to develop the strategy for investment which will be designed during the formal process.

Then a final document is produced and signed by all the participants assuring their full commitment to the plan, which leads us to implementation, which we plan would start in January of next year, when we will be ready to implement our target area investment program using the State and local incentives. We will then be in a position and prepared to apply for designation as an enterprise zone.

Now I would like to talk a moment about the incentives. The strategy that we are developing is based upon the needs of different kinds of businesses. We have been guided by accountants, investors, developers, corporate real estate officers, and our own experience.

We have also tested the incentives with the local development corporations, who are struggling to revitalize this area during the last two decades. Their experience has been vital to our understanding of the job that must be done. We have learned that one package of incentives is not suitable for all businesses, but that we must carefully tailor packages to meet the needs of targeted industry groups.

Committees have also learned that incentives necessary to assist in retaining the business are different than the incentives that are offered to attract new businesses.

I would like to use the elements for economic development, which I described earlier, as a framework to discuss the incentives: land, labor, business climate, capital, taxation, and regulation. Much of the information that I discuss is the product of indepth interviews with 60 businesses.

We found what I suspect is true in many other inner cities, that there are innumerable impediments to convenient expansion of existing businesses which have outgrown facilities.

One of the greatest difficulties confronting those businesses is the lack of suitable available land. Without competitively priced, prepackaged sites, the target area will not be able to compete with attractive, lower priced suburban locations. Therefore, the city must be able to assemble well-served sites of sufficient size to encourage development and redevelopment.

At the same time, we must be able to provide those sites to the ultimate users at a very competitive price in order to overcome what is expected to be low land and building appreciation associated generally with inner city development. These low prices and competitively served sites, and in combination with favorable finances and tax incentives, may then make city investment and location decisionmaking competitive with comparable suburban locations.

On a long-range basis, what is absolutely needed is a bold new program at the State or the Federal level which will provide local government with the moneys to acquire and improve real estate. The cost to a city to acquire and improve real estate for new development often doubles or triples its intrinsic economic value.

Without the moneys to accomplish these tasks up front, which would allow for write-downs, new development simply is not going to take place on any large scale.

A requirement which is directly related to land availability is providing for the necessary infrastructure or renovating that which exists are exorbitant and cities, quite frankly, just do not have the resources necessary to accomplish these tasks. We cannot ignore these major capital improvements that we have. It will cost us far less to upgrade them than it will to replace them.

There are existing Federal programs, such as the EDA Title I program, UDAG and the block grant programs, but careful, concentrated efforts must be made by local governments to make the most out of these resources.

As it relates to labor, in industries where Cleveland's labor rates are no longer competitive, we must improve labor-management dialog. In Cleveland, several programs are in place which are working on this.

We must also promptly identify industry groups where we are competitive and promote our area as a good place for those kinds of businesses.

Our committee made several recommendations to strengthen our ability to deliver job training and customized training.

Many businesses expressed a strong interest in the proposed wage credit for zone employee as an offsetting factor to the perception of crime and the reluctance of many potential workers to come into the zone.

Of all the incentives we suggested to businesses, climate-related incentives were the most important. They deal with cleaning up and landscaping, providing better security, city services, developing one-step business assistance offices, and making developers and business people feel welcome.

Financial assistance for business expansion must be made available on an expedited basis. Businesses react favorably to governmental programs which increase the availability of debt equity and working capital to firms located within the severely deteriorated areas and reduce the overall costs to assist businesses in these areas. Special——

The CHAIRMAN. I am going to have to ask that you summarize. We have a number of other witnesses.

Mr. GEUTHER. I will be done soon, sir.

Particularly we recommend that the total capital expenditure limitations on industrial revenue bond ceilings be eliminated.

At the same time, we would like you to remove the restrictions on the UDAG criteria so that they could be used to increase additional funds.

The existing businesses we interviewed all responded favorably to the possibility of any tax reductions, especially the renovation and building tax credit which you have added this year.

Mr. Chairman, I hope this statement has been useful to you and the members of the committee and we urge your early passage of the bill.

[The statement of Mr. Voinovich follows:]

City of Cleveland
GEORGE V. VOINOVICH, MAYOR

STATEMENT BY

GEORGE V. VOINOVICH, MAYOR
CITY OF CLEVELAND, OHIO

AND

RUSSELL L. GEUTHER, PARTNER
McDONALD AND COMPANY

ON BEHALF OF
THE CITY OF CLEVELAND
ON S. 863

THE ENTERPRISE ZONE EMPLOYMENT AND DEVELOPMENT ACT OF 1983
BEFORE THE
SENATE COMMITTEE ON FINANCE
U. S. SENATE

APRIL 22, 1983

Mr. Chairman and members of the Committee, I am George Voinovich, Mayor of Cleveland. I am also Second Vice President of the National League of Cities. I have with me Mr. Russell Geuther, whom I shall introduce more fully later.

I would ask, Mr. Chairman, that two documents be included in the Record in addition to our testimony. I have supplied copies to the Committee Staff. One is an extract of National Municipal Policy which discusses Enterprise Zones. This is the formal policy of the National League of Cities. The other is a booklet, Target Area Investment Program, which details our Enterprise Zone process in Cleveland.

As you know, the National League of Cities represents over 15,000 municipalities nation wide through the State Municipal Leagues and also about

1,000 DIRECT MEMBER CITIES. I AM PLEASED TO EMPHASIZE A FEW MATTERS CONCERNING THE ENTERPRISE ZONE WHICH ARE ESPECIALLY IMPORTANT BEYOND THE GENERAL STATEMENT OF NLC POLICY.

NLC IS IN STRONG SUPPORT OF THE ENTERPRISE ZONE CONCEPT AS A PUBLIC-PRIVATE EFFORT TO STIMULATE EMPLOYMENT AND ECONOMIC GROWTH IN AREAS OF POVERTY AND HIGH UNEMPLOYMENT. WE CONGRATULATE THE CHAIRMAN AND MEMBERS OF THIS COMMITTEE FOR THEIR CONTINUING INTEREST, MOST LATELY SHOWN BY THE HEARING BEING HELD TODAY.

ELIGIBILITY AND DESIGNATION

NLC SUPPORTS THE ELIGIBILITY REQUIREMENTS WHICH INCLUDE URBAN DEVELOPMENT ACTION GRANT (UDAG) ELIGIBILITY AND POCKETS OF POVERTY AND ATTAINMENT OF CERTAIN LEVELS OF DISTRESS. ONE CONCERN IS THE CONCEPT OF DUAL NOMINATION, BOTH STATE AND LOCAL, FOR ELIGIBILITY.

THIS AMOUNTS TO A STATE VETO. ENTERPRISE ZONES ARE LOCAL, BY THEIR VERY NATURE. IT IS THE PROVINCE OF THE LOCAL GOVERNMENT TO DESIGNATE AND PURSUE ITS ENTERPRISE ZONE. THE STATE SHOULD NOT BE ABLE TO DENY BASIC ELIGIBILITY. WHEN AN ACTION OF THE STATE LEGISLATURE IS REQUIRED, STATE CONCURRENCE MAY WELL FAIL BECAUSE OF LEGISLATION SCHEDULES OR SIMPLE INATTENTION.

REMOVING STATE VETO POWER DOES NOT MEAN THAT THE STATE SHOULD NOT HAVE A STRONG, COOPERATIVE ROLE. STATE, AS WELL AS LOCAL AND FEDERAL, MEASURES ARE NECESSARY FOR THE SUCCESS OF A ZONE. BUT THESE SHOULD BE CONSIDERED AS FACTORS OF COMPETITION, NOT OF ELIGIBILITY.

APPLICATION OF TAX INCENTIVES

NLC APPROVES THE BASIC THRUST OF PROVIDING TAX

INCENTIVES TO STIMULATE EMPLOYMENT OF DISADVANTAGED WORKERS AND FOR ECONOMIC DEVELOPMENT. WE RECOMMEND THAT A PROVISION BE ADDED SO THAT, WITHIN GENERAL GUIDELINES, THE LOCAL GOVERNMENT CAN FIX A REQUIRED LEVEL OF EMPLOYMENT OF DISADVANTAGED PERSONS TO MAKE A ZONE EMPLOYER ELIGIBLE. THE INCENTIVES SHOULD BE ATTRACTIVE TO A MIX OF BUSINESS: LARGE, SMALL, MANUFACTURING, COMMERCIAL, AND WITH A GENERAL EMPHASIS ON EMPLOYMENT.

THE TAX CREDITS IN THE BILL ARE NON-REFUNDABLE. THIS ADDRESSES THE NEEDS OF ALREADY ESTABLISHED BUSINESSES, ESPECIALLY WITH THE CARRY-FORWARD AND CARRY-BACK PROVISIONS. IT IS NOT RELEVANT TO THE NEEDS OF NEW, SMALL BUSINESS. THE MOST IMMEDIATE PROBLEM THE SMALL BUSINESSMAN FACES IS CASH FLOW, NOT PROFITS. INDEED, PROFITABILITY IS OFTEN YEARS IN THE FUTURE.

WORKING CASH IS A HERE-AND-NOW PROBLEM THAT HE NEEDS HELP WITH. REFUNDABILITY OF THE CREDITS WOULD BE A REAL HELP AND INCENTIVE FOR NEW BUSINESSES IN THE BUDDING ENTERPRISE ZONE.

RELATED FEDERAL PROGRAMS

THE ENTERPRISE ZONE WILL BE EFFECTIVE IF, AND ONLY IF, IT OPERATES IN CONJUNCTION WITH OTHER FEDERALLY SUPPORTED PROGRAMS. EDA PUBLIC WORKS GRANTS FOR INFRASTRUCTURE, HUD AND UDAG GRANTS FOR CAPITALIZATION, JOB TRAINING PROGRAMS TO ASSIST BOTH EMPLOYERS AND EMPLOYEES AND THE SMALL BUSINESS AND MINORITY BUSINESS DEVELOPMENT PROGRAMS FOR CREDIT AND TECHNICAL ASSISTANCE WILL BE PART AND PARCEL OF A SUCCESSFUL ZONE. WE URGE THE COMMITTEE TO MAKE PROVISION FOR CONTINUATION OF THESE PROGRAMS AND THEIR INTEGRATION INTO THE ENTERPRISE ZONE STRUCTURE.

Mr. Chairman, the comments I am going to make now are intended to supplement my testimony on behalf of the National League of Cities. I am speaking now for my city, Cleveland, Ohio, for its residents and business men and women as that city's Mayor.

Mr. Chairman, I have supported federal enterprise zone legislation with great interest since it was first introduced in June, 1980. I have followed the various revisions and alternatives to that legislation in the hope that the enterprise zone concept could be put in place in Cleveland. The Enterprise Zone Employment and Development Act of 1983 is the result of three years of discussion, debate and fine tuning. I believe that the changes and fine tuning of the enterprise zone concept should not be lost.

During those last three years, the City of

CLEVELAND, LIKE MANY CITIES ACROSS THE COUNTRY, HAS SUFFERED GREATLY FROM A RECESSION WHICH HAS TAKEN ITS TOLL IN LARGE NUMBERS OF UNEMPLOYED CITIZENS AND REDUCED TAX REVENUES. DURING THAT TIME BOTH FEDERAL AND STATE FUNDS HAVE BEEN REDUCED -- DOLLARS THAT WOULD HAVE ASSISTED PROJECTS TO HELP CREATE EMPLOYMENT OPPORTUNITIES FOR OUR CITIZENS.

DESPITE THOSE CUTS, WE HAVE LEARNED TO MAKE THE BEST POSSIBLE USE OF MONEY THAT FLOWS TO THE CITY. WITH THE ASSISTANCE OF PRIVATE SECTOR LEADERS, CITY GOVERNMENT IN CLEVELAND IS MORE EFFICIENT AND PRODUCTIVE THAN IT HAS BEEN FOR DECADES. OUR ABILITY TO LEVERAGE PRIVATE INVESTMENT HAS GROWN CONSIDERABLY.

I DO NOT BELIEVE THAT THE ENTERPRISE ZONE BILL IS A PANACEA OR COULD EVER REPLACE THE COMMUNITY DEVELOPMENT BLOCK GRANT PROGRAM, THE URBAN DEVELOPMENT

Action Grant Program or the programs of the Economic Development Administration. However, we still need to do a lot to create a climate conducive to new business development in our city.

Enterprise zone tax incentives alone might not create jobs in distressed inner cities of America. But the "course of action" necessary as part of the enterprise zone application requires cities to go through a thoughtful process to address their own particular needs. It allows for the differences in city capacity and economic conditions. Anticipation of enterprise zone legislation has caused hundreds of distressed communities across the country to learn to solve their own problems as they think through their "course of action."

Mr. Chairman, for the first time in recent

HISTORY, THIS LEGISLATION ATTEMPTS TO SOLVE BASIC URBAN PROBLEMS WITHOUT RELIANCE SOLELY ON THE RESOURCES AND THE WISDOM OF THE FEDERAL GOVERNMENT. THE STRENGTH OF THIS LEGISLATION, I BELIEVE, IS THE REQUIREMENT THAT LOCAL GOVERNMENTS WORK WITH STATE GOVERNMENTS, THE PRIVATE SECTOR, AND NEIGHBORHOOD RESIDENTS AND BUSINESSES TO COME UP WITH LONG-TERM SOLUTIONS TO ADDRESS THE VERY COMPLEX PROBLEMS OF URBAN BLIGHT.

PART OF MY ENTHUSIASM, MR. CHAIRMAN, FOR THE PROSPECTS OF BEING DESIGNATED AS AN ENTERPRISE ZONE CITY, IS THAT IT DOES NOT REQUIRE ADDITIONAL BUREAUCRACY OR ADDITIONAL STAFFING, EITHER IN CLEVELAND OR IN WASHINGTON. THE LEGISLATION PROPOSES A BOLD EXPERIMENTAL PROGRAM THAT WILL MAKE A LONG-TERM COMMITMENT TO DISTRESSED AREAS OF AMERICA. A COMBINATION OF LOCAL, STATE AND FEDERAL INCENTIVES WILL BE CAREFULLY

CONSTRUCTED MAXIMIZING PUBLIC RESOURCES TO LEVERAGE THE GREATEST POSSIBLE PRIVATE INVESTMENT.

I ALSO FEEL VERY STRONGLY THAT THE ENTERPRISE ZONE EMPLOYMENT AND DEVELOPMENT ACT OF 1983 COMPLEMENTS THE JOB TRAINING PARTNERSHIP ACT WHICH WE ARE WORKING DILIGENTLY TO IMPLEMENT. COORDINATING EMPLOYMENT TRAINING SERVICES BETWEEN BUSINESSES AND ZONE RESIDENTS WILL BE A KEYSTONE OF OUR ENTERPRISE ZONE PROGRAM.

MR. CHAIRMAN, I WOULD LIKE TO SPEAK A LITTLE ABOUT WHAT CLEVELAND HAS BEEN DOING TO PREPARE FOR ENTERPRISE ZONE LEGISLATION. WE HAVE NOT BEEN MARKING TIME WAITING FOR ACTION. THE CITY OF CLEVELAND WAS INSTRUMENTAL IN ITS SUPPORT FOR THE PASSAGE OF AN OHIO ENTERPRISE ZONE LAW. THE OHIO LAW OFFERS A PACKAGE OF LOCAL AND STATE INCENTIVES TO ENCOURAGE

BUSINESSES TO LOCATE IN ENTERPRISE ZONES. IT OFFERS REDUCTION IN TANGIBLE PERSONAL PROPERTY TAX, REAL PROPERTY TAX AND CORPORATE FRANCHISE TAX. IT ENCOURAGES HIRING DISADVANTAGED WORKERS THROUGH TRAINING AND DAY-CARE CREDITS FOR NEW EMPLOYEES HIRED BY ENTERPRISE ZONE FIRMS.

WE HAVE CHOSEN THE CITY'S MOST DISTRESSED AREA AND HAVE PROCEEDED WITH A COMPREHENSIVE REDEVELOPMENT PROGRAM FOR THE AREA. WITH THE SUPPORT OF CITY COUNCIL, CLEVELAND'S PRIVATE FOUNDATIONS, NEIGHBORHOOD RESIDENTS, COMMUNITY ORGANIZATIONS AND MORE THAN ONE HUNDRED VOLUNTEERS, WE HAVE DEVELOPED A PROCESS FOR TARGETING OUR RESOURCES TO BUILD ON THE STRENGTHS OF THE AREA. ONE OF THE GREATEST STRENGTHS IS THE PEOPLE WHO LIVE THERE AND THE NEIGHBORHOOD ORGANIZATIONS WHICH HAVE WORKED TO IMPROVE THE QUALITY OF LIFE FOR OUR RESIDENTS. THIS PROCESS WILL CONCENTRATE RESOURCES

AND SECURE COMMITMENTS TO A REDEVELOPMENT STRATEGY FOR OUR ENTERPRISE ZONE. THE PROCESS, WE BELIEVE, CAN BE USED IN OTHER AREAS OF THE CITY, OR COULD BE ADOPTED CITYWIDE OR REGIONALLY.

THE ENTERPRISE ZONE CONCEPT HAS BEEN THE CATALYST TO ADDRESS THE COMPLEX PROBLEMS OF INNER CITY BLIGHT AND UNEMPLOYMENT. WE ARE LEARNING THAT THERE IS A LOT MORE WE CAN DO AT THE LOCAL LEVEL TO RETAIN EXISTING FIRMS AND ENCOURAGE NEW BUSINESS DEVELOPMENT. BUT THE FORCES WHICH HELPED CREATE MIGRATION FROM THE INNER CITIES ARE VERY STRONG, INCLUDING SUBURBAN ACCESS TO THE INTERSTATE HIGHWAY SYSTEM AND A TAX STRUCTURE WHICH FAVORS NEW INVESTMENT IN NEW PLANTS. ASSEMBLING, CLEARING, SERVICING AND MAKING LAND AVAILABLE FOR DEVELOPMENT AT COSTS COMPETITIVE WITH SUBURBAN INDUSTRIAL PARKS IS ONLY ONE OF OUR TASKS. THE TAX

INCENTIVES OFFERED THROUGH THE ENTERPRISE ZONE ACT WILL HELP MAKE THE DECISIVE DIFFERENCES IN OUR ABILITY TO BE COMPETITIVE ONCE AGAIN.

MR. CHAIRMAN, I URGE THE SUPPORT OF THIS COMMITTEE TO PASS THE ENTERPRISE ZONE EMPLOYMENT AND DEVELOPMENT ACT OF 1983.

MR. CHAIRMAN, WITH ME TODAY IS THE COORDINATOR OF THE CITY'S ENTERPRISE ZONE PROGRAM WHICH WE CALL THE TARGET AREA INVESTMENT PROGRAM. I WOULD LIKE TO INTRODUCE MR. RUSSELL L. GEUTHER, A PARTNER WITH THE CLEVELAND-BASED INVESTMENT BANKING FIRM OF MCDONALD & COMPANY. MR. GEUTHER'S PARTNERS HAVE GENEROUSLY LOANED MR. GEUTHER TO MY ADMINISTRATION FOR THE LAST YEAR. HE HAS BEEN WORKING WITH MY STAFF, CITY COUNCIL AND MORE THAN 200 VOLUNTEERS FROM THE PRIVATE SECTOR, GOVERNMENT AGENCIES, THE ACADEMIC COMMUNITY AND

NEIGHBORHOODS TO SHAPE OUR PROGRAM. USING HIS EXPERIENCE IN FINANCING HUNDREDS OF FIRMS AND HIS KNOWLEDGE OF DECISION-MAKING BY CORPORATE EXECUTIVES, HIS PRIVATE SECTOR VIEW MAKES HIM ONE OF THE BEST PEOPLE I CAN THINK OF TO TESTIFY ON BEHALF OF THIS LEGISLATION.

MR. CHAIRMAN, AND MEMBERS OF THE COMMITTEE, THANK YOU.

* * *

REMARKS OF RUSSELL GEUTHER

Mr. Chairman, and members of the Committee, I am pleased to have the opportunity to testify before this committee in support of the Enterprise Zone Employment and Development Act of 1983. Since last May, I have had the unique opportunity to work with Mayor George Voinovich as a liaison between the business community and his office to coordinate Cleveland's enterprise zone program. For the last ten years, I have been in the business of financing business expansions. Before that I worked with Chambers of Commerce across the nation for 21 years. My experience with intergovernmental relations and my understanding of the "bottom line," I believe, Mr. Chairman, give me a balanced view of what kind of business response to government incentives can honestly be expected.

I MUST EXPLAIN SOME OF THE CONCERNS THAT I FELT WHEN I BEGAN TO UNDERSTAND THE COMPLEXITY OF MY ASSIGNMENT. THE GOALS OF THE ENTERPRISE ZONE PROGRAM ARE INDEED ADMIRABLE, AND HAVE BEEN SUPPORTED BY A BROAD RANGE OF CITIZENS AND BUSINESS PEOPLE. BUT AS I BEGAN TO UNDERSTAND THE DIFFICULTIES THE CITY HAS IN RETAINING AND ATTRACTING INVESTMENT, AND I BEGAN TO RECOGNIZE THE POWERFUL TREND WE ARE TRYING TO REVERSE, I KNEW THE FEDERAL ENTERPRISE ZONE INCENTIVES WOULD NOT BE ENOUGH STANDING ALONE. HOWEVER, THE LOCAL "COURSE OF ACTION" REQUIRED BY THE ENTERPRISE ZONE PROGRAM IS THE OPPORUNITY TO CAUSE THE COOPERATION OF ALL LEVELS OF GOVERNMENT, THE PRIVATE SECTOR, LOCAL RESIDENTS AND COMMUNITY ORGANIZATIONS TO SECURE THE RESOURCES AND COMMITMENTS NECESSARY FOR SUCCESS.

A PRIVATE BUSINESS MUST ESTABLISH GOALS AND

OBJECTIVES, AND THEN CAREFULLY STRUCTURE ITS ACTIVITIES TO INVEST ITS RESOURCES ACCORDING TO A STRATEGY DESIGNED TO MEET THOSE GOALS. IN THE SAME WAY, THE CITY MUST ALSO CREATE A STRATEGY FOR INVESTING ITS RESOURCES TO ATTRACT BUSINESSES AND CREATE JOBS.

FROM MY PERSPECTIVE, THERE ARE SEVERAL ESSENTIAL ELEMENTS TO AN ECONOMIC DEVELOPMENT STRATEGY: LAND; A TRAINED, COMPETITIVE LABOR FORCE; A GOOD BUSINESS CLIMATE; AND CAPITAL. I MIGHT ADD, MR. CHAIRMAN, THAT I BELIEVE CAPITAL WILL BE AVAILABLE IF THE FIRST THREE ARE IN PLACE BECAUSE THEN IT IS A GOOD LOAN. AFTER THAT, TAXATION AND REGULATION MAKE THE MARGINAL-BUT-OFTEN DEÇISIVE-DIFFERENCE IN A LOCATION DECISION.

I WOULD LIKE TO DO TWO THINGS TODAY. I WOULD LIKE TO SPEND A FEW MINUTES DESCRIBING THE PROCESS WE ARE USING HERE IN CLEVELAND TO DEVELOP OUR ENTERPRISE ZONE

STRATEGY, OUR "COURSE OF ACTION." AND I WOULD LIKE TO SHARE SOME OF OUR FINDINGS ABOUT WHAT INCENTIVES MUST BE A PART OF OUR STRATEGY.

STEP I: IDENTIFYING OBJECTIVES

DURING THE FIRST PHASE OF THE PROGRAM, WE IDENTIFIED THE BOUNDARIES OF THE PLANNING AREA AND INDIVIDUALS AND ORGANIZATIONS INTERESTED IN PARTICIPATING. COOPERATION WAS ENLISTED FROM PRIVATE-SECTOR ORGANIZATIONS, CHURCHES, AND SEVERAL DEVELOPMENT CORPORATIONS AND NEIGHBORHOOD GROUPS. AS RESULT OF THOSE EARLY CONTACTS, TWENTY SPECIFIC OBJECTIVES WERE OUTLINED THAT HAD TO BE ADDRESSED IF A PLAN FOR INVESTMENT AND REDEVELOPMENT COULD HOPE TO SUCCEED. INDIVIDUALS WERE ALSO IDENTIFIED WHO WERE WILLING TO SERVE ON COMMITTEES.

STEP II: FORMING COMMITTEES

The objectives were organized into groups, and committees were formed to meet those objectives. Committees were made up of private sector leaders, City Administration, City Council, neighborhood residents and experts. All volunteered their talents to the program. The committees were Economic Development, Community Development, Physical Development, Management, Public Information, and Legislation. The committees met, developed work programs and began to address their objectives.

STEP III: PROGRAM DEVELOPMENT

Beginning last summer, each committee searched for information. Some of their questions lead them to specific recommendations. Others only generated information which has become part of the data base for further

INQUIRIES. IN ALL CASES, THE APPROACH WAS TO START WITH A FIRM FOUNDATION AND NOT ON THE SECOND FLOOR.

STEP IV: PROGRAM REVIEW

THE URBAN LAND INSTITUTE WILL CONDUCT A PANEL ADVISORY REVIEW OF OUR ENTERPRISE ZONE AREA AND OUR DEVELOPMENT PROGRAM DURING THE FIRST WEEK OF JUNE. THEIR REVIEW WILL SERVE AS A "MID-COURSE CORRECTION" AND THEIR IDEAS CAN BE INCORPORATED INTO OUR FINAL ENTERPRISE ZONE STRATEGY.

STEP V: SECURING RESOURCES

THE NEGOTIATED INVESTMENT STRATEGY PROCESS WILL BE USED IN ORDER TO SECURE AGREEMENTS FROM VARIOUS LEVELS OF GOVERNMENT, THE PRIVATE SECTOR AND COMMUNITY RESIDENTS. USING A NEUTRAL MEDIATOR TO RESOLVE DIFFERENCES, AGREEMENT TO ISSUES AND TO THE STRATEGY FOR INVESTMENT WILL BE REACHED DURING A FORMAL PROCESS.

A FINAL DOCUMENT WILL BE PRODUCED AND SIGNED BY ALL PARTICIPANTS ASSURING THEIR FULL COMMITMENT TO THE PLAN.

STEP VI: IMPLEMENTATION

IN JANUARY OF NEXT YEAR, WE WILL BE READY TO IMPLEMENT OUR TARGET AREA INVESTMENT PROGRAM USING STATE AND LOCAL INCENTIVES. THEN WE WILL BE PREPARED TO APPLY FOR DESIGNATION FOR AN ENTERPRISE ZONE.

* * * * *

THE STRATEGY THAT WE ARE DEVELOPING IS BASED UPON THE NEEDS OF DIFFERENT KINDS OF BUSINESSES. WE HAVE BEEN GUIDED BY ACCOUNTANTS, INVESTORS, DEVELOPERS, CORPORATE REAL ESTATE OFFICERS AND OUR OWN EXPERIENCE. WE HAVE ALSO TESTED THESE INCENTIVES WITH THE LOCAL DEVELOPMENT CORPORATIONS STRUGGLING TO REVITALIZE THESE AREA DURING THE LAST TWO DECADES. THEIR EXPERIENCE HAS BEEN VITAL TO OUR UNDERSTANDING THE JOB THAT

MUST BE DONE.

WE HAVE LEARNED THAT ONE PACKAGE OF INCENTIVES IS NOT SUITABLE FOR ALL BUSINESSES, BUT THAT WE MUST CAREFULLY TAILOR PACKAGES TO MEET THE NEEDS OF TARGETED INDUSTRY GROUPS. OUR COMMITTEES HAVE ALSO LEARNED THAT THE INCENTIVES NECESSARY TO ASSIST IN RETAINING THE BUSINESSES THAT WE HAVE ARE DIFFERENT THAN THE INCENTIVES THAT MUST BE OFFERED TO ATTRACT NEW BUSINESSES.

MR. CHAIRMAN, I WOULD LIKE TO USE THE ELEMENTS FOR ECONOMIC DEVELOPMENT WHICH I DESCRIBED EARLIER AS A FRAMEWORK TO DISCUSS THE INCENTIVES: LAND, LABOR, CLIMATE, CAPITAL, TAXATION AND REGULATION. MUCH OF THE INFORMATION I WILL DISCUSS IS THE PRODUCT OF IN-DEPTH INTERVIEWS WITH SIXTY BUSINESSES IN OUR ENTERPRISE ZONE.

LAND

WE HAVE FOUND WHAT I SUSPECT IS TRUE IN MANY OTHER INNER CITIES -- THAT THERE ARE INNUMERABLE IMPEDIMENTS TO CONVENIENT EXPANSION OF EXISTING BUSINESSES WHICH HAVE OUTGROWN FACILITIES. ONE OF THE GREATEST DIFFICULTIES CONFRONTING THOSE BUSINESSES IS THE LACK OF SUITABLE, AVAILABLE LAND. WITHOUT COMPETIVELY PRICED, PREPACKAGED SITES, THE TARGET AREA WILL NOT BE ABLE TO COMPETE WITH ATTRACTIVE, LOWER PRICE SUBURBAN LOCATIONS. THEREFORE, THE CITY MUST BE ABLE TO ASSEMBLE WELL-SERVED SITES OF SUFFICIENT SIZE TO ENCOURAGE DEVELOPMENT AND REDEVELOPMENT. AT THE SAME TIME, WE MUST ALSO BE ABLE TO PROVIDE THOSE SITES TO THE ULTIMATE USERS AT VERY COMPETITIVE PRICES, IN ORDER TO OVERCOME WHAT IS EXPECTED TO BE LOW LAND AND BUILDING APPRECIATION ASSOCIATED GENERALLY WITH INNER CITY DEVELOPMENT. THESE LOW PRICES AND COMPLETELY

SERVED SITES, AND IN COMBINATION WITH FAVORABLE FINANCES AND TAX INCENTIVES, MAY THEN MAKE CITY INVESTMENT AND LOCATION DECISION MAKING COMPETITIVE WITH COMPARABLE SUBURBAN DECISIONS.

ON A LONG-RANGE BASIS, WHAT IS ABSOLUTELY NEEDED IS A BOLD NEW PROGRAM AT THE STATE OR THE FEDERAL LEVELS WHICH WILL PROVIDE LOCAL GOVERNMENT WITH THE MONIES TO ACQUIRE AND IMPROVE REAL ESTATE. THE COST TO A CITY TO ACQUIRE AND IMPROVE REAL ESTATE FOR NEW DEVELOPMENT OPTEN DOUBLES OR TRIPLES ITS INTRINSIC ECONOMIC VALUE. WITHOUT THE MONIES TO ACCOMPLISH THESE TASKS UP FRONT, WHICH WOULD ALLOW FOR WRITE-DOWNS, NEW DEVELOPMENT SIMPLY IS NOT GOING TO TAKE PLACE ON ANY LARGE SCALE.

A REQUIREMENT, WHICH IS DIRECTLY RELATED TO LAND AVAILABILITY, IS PROVIDING FOR THE NECESSARY PUBLIC

INFRASTRUCTURE OR RENOVATING THAT WHICH EXISTS ARE EXORBITANT AND CITIES, QUITE FRANKLY, JUST DO NOT HAVE THE RESOURCES NECESSARY TO ACCOMPLISH THESE TASKS. THERE ARE EXISTING FEDERAL PROGRAMS SUCH AS THE E.D.A. TITLE I PROGRAM UDAG AND THE COMMUNITY DEVELOPMENT BLOCK GRANT, BUT CAREFUL, CONCERTED EFFORTS MUST BE MADE BY LOCAL GOVERNMENTS TO MAKE THE MOST OUT OF THESE RESOURCES.

LABOR

IN INDUSTRIES WHERE CLEVELAND'S LABOR RATES ARE NO LONGER COMPETITIVE, WE MUST IMPROVE LABOR AND MANAGEMENT DIALOGUE. IN CLEVELAND, SEVERAL PROGRAMS ARE IN PLACE WHICH ARE WORKING ON THIS. WE MUST ALSO IDENTIFY INDUSTRIES IN WHICH WE ARE COMPETITIVE AND PROMOTE OUR AREA AS A GOOD PLACE FOR THOSE KINDS OF BUSINESSES.

OUR COMMITTEE HAS MADE SEVERAL RECOMMENDATIONS TO STRENGTHEN OUR ABILITY TO DELIVER JOB TRAINING SERVICES, "CUSTOMIZED TRAINING" TO EMPLOYERS. THESE RECOMMENDATIONS WILL BE COORDINATED WITH OUR PRIVATE INDUSTRY COUNCIL.

OHIO TRAINING CREDITS OF $1,000 FOR EACH EMPLOYEE AND $300 FOR DAY CARE ALONG WITH THE PROPOSED FEDERAL TAX CREDIT WILL BE AN INCENTIVE TO BUSINESS TO HIRE DISADVANTAGED WORKERS. AT LEAST IT IS A BEGINNING.

MANY BUSINESSES EXPRESSED A STRONG INTEREST IN THE PROPOSED WAGE CREDIT FOR ZONE EMPLOYEES AS AN OFFSETTING FACTOR TO THE PERCEPTION OF CRIME AND RELUCTANCE OF MANY POTENTIAL WORKERS TO COME INTO THE ZONE.

BUSINESS CLIMATE

OF ALL INCENTIVES WE SUGGESTED TO BUSINESSES, CLIMATE-RELATED INCENTIVES WERE THE MOST IMPORTANT.

WE BELIEVE STRONGLY THAT LOCAL GOVERNMENT MUST DO THE FOLLOWING:

- CLEAN AND LANDSCAPE
- PROVIDE BETTER SECURITY
- IMPROVE CITY SERVICES
- DEVELOP A "ONE-STOP" BUSINESS ASSISTANCE OFFICE
- MAKE DEVELOPERS AND BUSINESS PEOPLE FEEL WELCOME.

CAPITAL

FINANCIAL ASSISTANCE FOR BUSINESS EXPANSION PROJECTS MUST BE MADE AVAILABLE ON AN EXPEDITED BASIS. BUSINESSES WILL REACT FAVORABLY TO GOVERNMENTAL PROGRAMS WHICH INCREASE THE AVAILABILITY OF DEBT EQUITY AND WORKING CAPITAL TO FIRMS LOCATED WITHIN SUCH SEVERLY DETERIORATED AREAS AND WHICH REDUCE THE OVERALL COSTS TO ASSIST BUSINESSES IN SUCH AREAS. SPECIAL CONSIDERATION MUST BE GIVEN BUSINESSES CURRENTLY LOCATED WITHIN OR PLANNING TO LOCATE IN AN

ENTERPRISE ZONE.

In Cleveland, industrial revenue bonds have been very successfully used individually and in combination with other financial systems programs to stimulate new development and redevelopment in our City. In fact, about one-half of all IRB issues in Cuyahoga County, Ohio have been used to assist business expansion projects in the City of Cleveland. We are very supportive of industrial revenue bonds as a means of supporting a development or redevelopment strategy in enterprise zones even if they are not available elsewhere. More particularly, the total capital expenditure limits on the bond ceiling in enterprise zones should be abandoned.

At the same time, we would encourage less restrictive UDAG criteria for projects in an enter-

PRISE ZONES SHOULD BE ABANDONED.

AT THE SAME TIME, WE WOULD ENCOURAGE LESS RESTRICTIVE UDAG CRITERIA FOR PROJECTS IN AN ENTERPRISE ZONE.

THE COMMITTEE MIGHT ALSO BE INTERESTED TO KNOW THAT THE BUSINESSMEN AND WOMEN WE INTERVIEWED BELIEVED THAT INTEREST RATES AT 8-9% WOULD MAKE A DECISIVE DIFFERENCE IN THEIR FINANCIAL PLANNING.

TAX

THE BUSINESSES WE INTERVIEWED ALL RESPONDED FAVORABLY TO THE POSSIBILITY OF ANY TAX REDUCTIONS. THE GREATEST POSITIVE RESPONSE WAS TO THE CAPITAL INVESTMENT TAX CREDIT PROPOSED IN THE LEGISLATION WE ARE HERE TO SUPPORT. STATE TAX REDUCTIONS OFFERED BY OUR OHIO ENTERPRISE ZONE LAW RECEIVED THE NEXT MOST-FAVORED RESPONSE.

WE WOULD EXPECT A SOMEWHAT DIFFERENT ANSWER AND EMPHASIS IF OUR INTERVIEWS HAD BEEN WITH BUSINESSES WE HAD HOPED TO ATTRACT. BUT EVEN THE MARGINAL DIFFERENCES WHICH TAX RELIEF MIGHT BRING COULD BE THE DECISIVE DIFFERENCE IN ATTRACTING A BUSINESS TO THE ENTERPRISE ZONE AND MUST BE PART OF OVERALL STRATEGY.

REGULATION

FOR THE MOST PART, WE HAVE BEEN UNABLE TO DETERMINE SPECIFIC STATE AND FEDERAL REGULATIONS WHICH BUSINESSES FIND HARD TO ACCEPT. THE LOCAL REGULATIONS WITH WHICH THEY DIFFER, FOR THE MOST PART, ARE INCLUDED IN THE AREA OF BUSINESS CLIMATE.

MR. CHAIRMAN, I HOPE THIS STATEMENT HAS BEEN USEFUL TO YOU AND THE MEMBERS OF THIS COMMITTEE. I URGE YOU TO SUPPORT THE ENTERPRISE ZONE AND DEVELOPMENT ACT OF 1983.

THANK YOU.

National
League
of
Cities

1301 Pennsylvania Avenue NW
Washington, D.C.
20004
(202) 626-3000
Cable NLCITIES

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NLC Proposal for Amendments to
Enterprise Zones Bill

April 22, 1983

1) State role. The bill gives states a virtual veto over any community's application for designation. Instead, we suggest that applications be made only by local governments. We suggest further that program involvement by states be included in the fourth category of possible elements to be offered in the "course of action" that must be submitted as part of any application. Thus, state involvement could enhance a locality's application, but lack of state involvement could not prevent that application. Furthermore, the lack of state involvement could be balanced by strengthening other elements of that locality's course of action.

2) Designation process. In order to avoid unnecessary expenditures of local resources by municipalities in preparing enterprise zone applications for the limited number of zones to be designated nationwide, we urge that there be a two tier-preapplication process.

The first tier would include a comprehensive local investment strategy for the zone; thereby enabling localities to know at an early point whether their application for designation would receive no further consideration. This provision could be included in the bill as report language instructing HUD to develop such a process or through appropriate amendments to the bill.

3) Allowing flexibility in the local course of action. (a) The bill should authorize a procedure by which a locality with a designated zone may request and the Secretary may approve one or more changes in elements of the course of action. Those elements included in the application will be geared to solving the problems of the zone area as they exist at the time of the application and, insofar as prediction is possible, as they will exist in the future.

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But such prediction is difficult and -- if the zone incentives work -- circumstances in the zone may change very substantially over the 24 year life of the zone. Such a changed context in a zone could also substantially change the effect and the meaning of any particular element in the course of action and therefore a means of amending it, after careful deliberation and review, is needed. (b) The bill should also allow a locality to propose differing durations for different elements in the course of action. This would lessen (but not eliminate) the need for amendments and would encourage more sophisticated local planning.

4) Revocation of designation. The bill allows the Secretary to revoke a zone designation if he determines that a local (or state) government is not complying with its commitments under the "course of action". The bill should require a process of notification and negotiation prior to a revocation; it should allow for amendments to the course of action, where that is appropriate, rather than revocation; and it should stipulate the fate of tax incentives for business that exist in the zone at the time of revocation.

5) Nature of the "course of action". The Report on the bill from the Senate Finance Committee says that the "course of action" should be "designed to reduce the various burdens borne by employers or employees in the area". We suggest avoiding the anti-government philosophical bias implied by this "burdens" approach. Instead, we suggest that the bill, or at least the Report, provide that the local government, first, delineate the problems of the area and the goals that are sought and, second, describe how the elements in the course of action will address those problems and achieve those goals. This "problems/solutions" approach is more likely to allow for local flexibility and ingenuity than the more prescriptive "removing burdens" approach.

6) Treatment of prior efforts. HUD should be instructed to value new or promised local commitments in a zone neither less nor more highly than previous or on-going efforts and assistance.

7) Minimizing tax losses. Two of the "additional characteristics" which lead to "higher evaluation" of an application include a provision for "minimizing unnecessary Federal tax losses." NLC supports efforts to avoid windfalls and to make the tax incentives function efficiently. We are concerned, however, that, unless "unnecessary" in this provision is emphasized and re-emphasized, this could lead to a concern simply with minimizing Federal tax losses. Given the "incentive" approach of this program, revenue "losses" will increase with the success of the zone. An effort to prevent such "losses" would be detrimental to the success of the program. We believe that HUD and Treasury can be expected, without specific direction,

to avoid wasting Federal tax expenditures. Therefore, we suggest eliminating the references to minimizing tax loss under the "priority of designation" section. (If this is not possible, then we suggest that additional Report language make clear that the emphasis in this provision is on "unnecessary".)

8) Relation to other Federal programs. We oppose any set-asides for EZ areas in other Federal programs. We support adequate funding for these programs so that designated EZ localities can apply for assistance through them.

9) Uniform Relocation Act. We oppose excluding EZs from coverage by the Uniform Relocation Act.

10) Disadvantaged Individuals. The definition of "disadvantaged individuals" (used for computing one of the tax credits for increased zone employemnt) is unduly restrictive and seems programatically inconvenient. We suggest that the definition in this bill be the same as the definition of "economically disadvantaged" in the Job Training Partnership Act. This would facilitate certification of individuals and coordination of programs.

11) Hiring requirement. The bill provides substantial tax reductions to zone firms regardless of whether they create jobs for structurally unemployed or disadvantaged persons. Because we believe that creating jobs for such person must be a primary objective of the program, we suggest that the bill impose hiring requirements which firms must meet in order to qualify for most of the tax incentives. (The tax credit for hiring "disadvantaged" workers should be exempt from such a requirement.) This hiring requirement should stipulate that 30% of a firm's jobs that are new to the zone should be filled by "economically disadvantaged" persons as defined by the Job Training Partnership Act. Localities should be allowed, in their local "course of action" proposal, to request that the Secretary allow them to raise or lower this percentage by as much as half (i.e., up to 45% or down to 15%). Exemptions should be allowed for small and new businesses.

12) Employee tax credit. The Kemp-Garcia bill provided a tax credit to employees to encourage dependent disadvantaged persons to take jobs and to offset the heavy marginal tax rate incurred by the transition. We believe this is a good idea. To minimize unnecessary Federal tax losses, we suggest that the tax credit be available only to employees whose job incomes are below, say, $12,000.

13) Tax incentives to attract capital to small and new firms. The bill has been especially criticized for not providing incentives that will address the capital formation problems of small and new businesses. We suggest including such incentives. As to debt, the exclusion from taxation of all or part of interest earned on loans to zone firms (contained in the Kemp-Garcia bill) is one possibility. As to equity, the proposal for "expensing" investments also seems reasonable. In addition or as an alternative, we also found the concept of a refundable tax credit useful in dealing with the problem of cash flow and "up front" money. Whatever the technique, we believe this issue should be dealt with in the bill.

The CHAIRMAN. Thank you very much, and we will make the entire statement a part of the record, but we have about 10 or 12 witnesses remaining.

I would like, before I hear Hon. Mayor of Toledo, to interrupt just for a couple of minutes so that Senator Boschwitz might make his statement. He has, as indicated earlier, been one of the pioneers in this effort and we are pleased to have Senator Boschwitz with us.

STATEMENT OF HON. RUDY BOSCHWITZ, A U.S. SENATOR FROM THE STATE OF MINNESOTA

Senator BOSCHWITZ. Thank you, Mr. Chairman. I appreciate also the indulgence of the mayors. I will be brief. I have testified a number of times before this committee on the Enterprise Zone bill which I have introduced, together with Senator Chafee and many witnesses of the administration.

Mr. Chairman, I am surprised you can be here in committee. Since last August you have been on the floor, since the TEFRA bill, which led to the Highway bill, and then the Social Security bill. You and Senator Long have more or less run the Senate. And now the withholding bill. It is a credit to your legislative skill that you were able to forge a compromise, having as few votes as you did. [Laughter.]

The CHAIRMAN. I was thinking about putting enterprise zones on there, but I couldn't get any support for that either.

Senator BOSCHWITZ. Oh, no. And now I see that Tuesday, the Bankruptcy bill will be up and you will be on the floor again. So I salute you and salute Senator Long, two really legislative colossi here in the Senate.

I appreciate the opportunity to speak once again about the Enterprise Zone bill. I ask that my entire statement be made part of the record and I would like to just cite from a small part of it because I have testified so many times before and we have talked about it. Certainly Senator Chafee knows my thoughts and I know his thoughts about it. We have gone into it in great detail.

Mr. Chairman, at this time of double digit unemployment, we need enterprise zones, in my judgment, more than ever. As the economy turns around, more and more Americans will go back to work, but the need for enterprise zones will be increasingly evident in areas of structural unemployment, where jobs have been lost due to changing industries as much as to a sagging economy.

Areas such as Minnesota's Iron Range, where the jobless have been stung by the ravages of structural unemployment more than by the state of the economy, are areas where enterprise zones can really give a boost. The Iron Range is a portion of northeastern Minnesota, where ore has been produced for a number of years, but which is now a depressed area with 20 percent, 30 percent, and sometimes higher rates of unemployment in some communities up there.

The unemployment in our State has, by and large, been lower than the Nation as a whole, but recently it has been at the national average and rising, while the national average has been going down. Our unemployment has been going up basically because of the iron ore industry.

So enterprise zones, which would lead to the establishment of new businesses, particularly small businesses, would be of great help to an area like the Iron Range—an area of structural unemployment.

That is the basis and thrust of my testimony this morning, Mr. Chairman. My bill is a little bit different from the administration's bill in that it allows for the deduction, or expensing, of initial investments in zone businesses. I understand that Congressman Garcia spoke about that this morning and has shown some interest in it. Perhaps we will work that out as the bill proceeds.

But the structural unemployment that we are now experiencing in our State, particularly in northeastern Minnesota, simply doesn't go away with the recovery of the economy. Still it is something that I think will be helped—not solved, but helped—by the enterprise zone concept, which is another step and another means of fighting unemployment in our country.

I thank you once again, Mr. Chairman.

[The statement of Senator Boschwitz follows:]

TESTIMONY OF SENATOR RUDY BOSCHWITZ
BEFORE THE SENATE FINANCE COMMITTEE
ON ENTERPRISE ZONE LEGISLATION
APRIL 22, 1983

MR. CHAIRMAN, I COMMEND YOU FOR HOLDING THESE HEARINGS ON ENTERPRISE ZONE LEGISLATION SO PROMPTLY AND APPRECIATE THE OPPORTUNITY TO TESTIFY ON THE BILLS THAT HAVE BEEN REFERRED TO YOUR COMMITTEE. THE BROAD SUPPORT FOR ENTERPRISE ZONES IS EVIDENT FROM THE MEMBERS OF THIS COMMITTEE WHO HAVE CO-SPONSORED LEGISLATION -- SENATORS DOLE, CHAFEE, DANFORTH, ROTH, HEINZ, GRASSLEY, DURENBERGER, MATSUNAGA AND BRADLEY. IN FACT, 37 SENATORS JOINED ME IN INTRODUCING THE ADMINISTRATION'S PROPOSAL ON MARCH 18.

THE ENTERPRISE ZONE CONCEPT HAS GATHERED IMPRESSIVE BIPARTISAN SUPPORT, INCLUDING REPEATED AFFIRMATIONS BY PRESIDENT REAGAN. I AM PLEASED THAT PRESIDENT REAGAN CALLED FOR ENACTMENT OF ENTERPRISE ZONE LEGISLATION IN HIS STATE OF THE UNION MESSAGE, AND THAT HE RECENTLY CONFIRMED HIS PERSONAL SUPPORT BY MEETING WITH THE PRINCIPAL SPONSORS AT THE WHITE HOUSE.

WHILE THE PRESIDENT'S COMMITMENT IS IMPORTANT, THE CONTINUED EFFORTS IN CONGRESS ARE NEEDED TO ACHIEVE OUR GOAL AND ENACT RESPONSIBLE ENTERPRISE ZONE LEGISLATION.

I COMMEND SENATOR CHAFEE FOR HIS EFFORTS AND AM CONFIDENT THAT WE CAN, WITH THE SUPPORT OF OUR COLLEAGUES, ACHIEVE OUR GOAL.

IN THIS TIME OF DOUBLE DIGIT UNEMPLOYMENT, WE NEED ENTERPRISE ZONES MORE THAN EVER. AS THE ECONOMY TURNS AROUND, MORE AND MORE AMERICANS WILL GO BACK TO WORK, BUT THE NEED FOR ENTERPRISE ZONES WILL BE INCREASINGLY EVIDENT IN AREAS OF STRUCTURAL UNEMPLOYMENT -- WHERE JOBS HAVE BEEN LOST TO CHANGING INDUSTRIES MORE THAN TO A SAGGING ECONOMY. AREAS SUCH AS MINNESOTA'S IRON RANGE, WHERE THE JOBLESS HAVE BEEN STUNG BY THE RAVAGES OF STRUCTURAL UNEMPLOYMENT, CAN USE THE BOOST THE ENTERPRISE ZONES CAN PROVIDE.

THE IRON RANGE IS AN AREA OF NORTHEASTERN MINNESOTA THAT HAS FELT THE PRESSURE OF OUR CURRENT ECONOMY AS MUCH AS ANY AREA IN THE COUNTRY. WITH ITS TREMENDOUS DEPENDENCE ON THE DEPRESSED STEEL INDUSTRY, THE RANGE IS EXPERIENCING 20 PERCENT UNEMPLOYMENT WITH POCKETS OF THE AREA EXPERIENCING TWO OR THREE TIMES THAT MUCH.

MY STATE OF MINNESOTA HAD AN UNEMPLOYMENT RATE OF 10.4 PERCENT IN FEBRUARY -- BASICALLY THE NATIONAL RATE. BUT WHILE THE NATIONAL RATE HAS BEEN FALLING, MINNESOTA'S RATE HAS GONE FROM 8.6 PERCENT IN NOVEMBER TO 9.3 PERCENT IN DECEMBER TO 10.4 PERCENT IN FEBRUARY. AS OF FEBRUARY 28, 217,000 MINNESOTAS WERE UNEMPLOYED.

Unfortunately, Mr. Chairman, these numbers don't tell the whole story. Northeastern Minnesota (the Iron Range) has an unemployment rate about 20 percent. Many pockets have unemployment rates double and triple that because the mines are shut down.

The Iron Range mines taconite, a low-grate ore that is processed into high-grade pellets and then shipped to the eastern steel mills. When shipments are down, the Port of Duluth suffers too -- as ore and grain are the major commodities handled there. U.S. Steel owns the largest mine on the Range and they closed it June 6, 1982. This alone put 3,750 people out of work.

Mr. Chairman, the term structural unemployment is often used when economists and others talk about unemployment, but we rarely hear about it when Congress addresses the problems of the unemployed.

I believe that before we try to rewrite the Federal government's role and responsibilities towards the unemployed, we must first clearly differentiate between recession-related unemployment and structural unemployment.

Recession-related unemployment comes about because during a business downturn, fewer goods are produced, fewer goods are shipped, fewer goods are stored, and fewer goods are purchased. This means fewer people are needed to handle

THESE JOBS. SO, DURING A RECESSION, UNEMPLOYMENT NORMALLY WILL INCREASE. BUT AS SOON AS THE ECONOMY PICKS UP (AS IT IS SHOWING SIGNS OF DOING NOW) THESE JOBS WILL REAPPEAR.

THIS IS NOT THE CASE WITH STRUCTURAL UNEMPLOYMENT. HERE, JOBS ARE LOST BECAUSE OF SOCIAL OR TECHNOLOGICAL FACTORS -- BASICALLY UNRELATED TO OVERALL ECONOMIC STRENGTH OR WEAKNESS. THESE PEOPLE WILL NOT BE AIDED BY "JOBS BILLS" OR MAKE-WORK PROJECTS EXCEPT IN THE VERY SHORT TERM. I BELIEVE THAT ENTERPRISE ZONES DIRECTLY ADDRESS SOME OF THE PROBLEMS OF STRUCTURAL UNEMPLOYMENT.

AS A SUPPORTER OF ENTERPRISE ZONES, I VIEW THE PROBLEM OF JOBLESSNESS LIKE THIS: THERE ARE NO JOBS BECAUSE THERE ARE NOT ENOUGH OPPORTUNITIES IN THE AREAS THAT NEED THEM THE MOST. ENTERPRISE ZONES WOULD ENCOURAGE JOB CREATION THROUGH A FEDERAL/LOCAL PACKAGE OF TAX BREAKS AND OTHER INCENTIVES FOR BUSINESSES WHICH LOCATE IN A DESIGNATED ZONE.

THERE ARE MANY PROBLEMS FACED BY BUSINESSES WISHING TO LOCATE IN ENTERPRISE ZONES THAT CANNOT BE CORRECTED BY THE FEDERAL GOVERNMENT ALONE. SUCH PROBLEMS AS CRIME, WEAK INFRASTRUCTURE SUPPORT, AND CITY TAXES REMAIN BARRIERS TO BUSINESS DEVELOPMENT. THESE SERVE AS A DOUBLE WHAMMY WHEN YOU CONSIDER THAT A PROSPECTIVE BUSINESS ALREADY FACES THE USUAL PROBLEMS OF TAX BURDENS, START-UP CAPITAL AND TECHNICAL EXPERTISE.

ENTERPRISE ZONES ADDRESS THESE PROBLEMS BY COMBINING INCENTIVES PROVIDED BY THE FEDERAL GOVERNMENT WITH THOSE OF LOCAL GOVERMENTS. SHOWING SIGNS OF HIGH UNEMPLOYMENT, POVERTY, OR OUT-MIGRATION IS NOT ENOUGH FOR AN AREA TO QUALIFY FOR AN ENTERPRISE ZONE DESIGNATION. THE LOCAL GOVERNMENT MUST ALSO ASSEMBLE A PACKAGE OF TAX AND OTHER INCENTIVES THAT MEET THE PARTICULAR PROBLEMS OF THE AREA. MOREOVER, THE AWARD OF AN ENTERPRISE ZONE WILL BE GRANTED ON A COMPETITIVE BASIS TO TEST LOCAL COMMITMENT. THAT COULD INCLUDE ANY NUMBER OF THINGS, SUCH AS IMPROVED INFRASTRUCTURE SUPPORT, REDUCTION OF LOCAL TAXES, RELAXATION OF LOCAL REGULATIONS, MANAGERIAL ASSISTANCE AND TECHNICAL HELP.

THESE LOCAL CONTRIBUTIONS ARE THEN MATCHED BY FEDERAL TAX BREAKS, SUCH AS THE ELIMINATION OF CAPITAL GAINS TAXES FOR BUSINESS INVESTMENT IN THE AREA, SIGNIFICANT REDUCTIONS IN INCOME TAXES, AND TAX CREDITS FOR WAGES PAID TO PREVIOUSLY UNEMPLOYED WORKERS. THIS LOCAL/FEDERAL PACKAGE ADDRESSES THE PROBLEMS THAT ALL SMALL BUSINESSES FACE, AS WELL AS THE PARTICULAR PROBLEMS OF A BUSINESS LOCATED IN A DEPRESSED AREA.

ENTERPRISE ZONE LEGISLATION SHOULD BE AIMED PRIMARILY AT SMALL BUSINESS BECAUSE THEY CREATE THE VAST MAJORITY OF NEW JOBS. IN THE PAST TEN YEARS NEARLY 20 PERCENT OF NEW PRIVATE-SECTOR EMPLOYMENT HAS COME FROM BUSINESSES WITH 20 OR FEWER EMPLOYEES. EIGHTY PERCENT OF NEW JOBS HAVE BEEN CREATED BY BUSINESSES WITH LESS THAN 100 EMPLOYEES.

My faith in business goes much deeper than statistics. My experience as a businessman has shown me that small businesses offer an increased opportunity for rapid advancement when compared with larger corporations. People at the lower end of the wage scale are not so easily lost in the shuffle; the small businessman is far more involved with the lives of his employees. A worker's qualities, problems, family and ambitions do not easily escape the boss' notice. Getting in on the ground floor of a small business is a very effective method of advancement, but most important, it stands in stark contrast from welfare.

Mr. President, S. 863 -- the Administration's bill -- addresses these issues directly. The bill provides incentives for businesses that will expand entrepreneurial activity in the zones, and includes incentives that will encourage the poor on welfare to seek taxpaying jobs and given them a stake in their community. This bill embraces the basic legislation that was reported by the Finance Committee last year but makes additional changes that I believe improve that bill and should be included in the legislation enacted into law.

I first introduced enterprise zone legislation over two years ago, and support for it has come from many sources -- both conservative and liberal. I renewed my support for enterprise zones when I introduced S. 98 on January 26, 1983. Both the Administration's proposal and S. 98 seek the same goal and are quite similar. Even so, I would like to

DISCUSS THE MOST SUBSTANTIAL DIFFERENCES.

THE ADMINISTRATION'S PROPOSAL INCLUDES TWO PROVISIONS THAT ARE NOT CONTAINED IN S. 98. FIRST, ZONE EMPLOYEES WOULD RECEIVE A PERSONAL TAX CREDIT OF UP TO 5 PERCENT FOR WAGES EARNED IN THE ZONE. THIS CREDIT IS LIMITED BY ONE AND ONE-HALF TIMES THE FUTA WAGE BASE -- CURRENTLY A MAXIMUM CREDIT OF $450 PER EMPLOYEE.

SECOND, THE EMPLOYMENT TAX CREDITS FOR EMPLOYERS THAT HIRE QUALIFIED WORKERS WOULD BE RETROACTIVE FOR BUSINESSES THAT LOCATE IN STATE-DESIGNATED ZONES THAT ARE SUBSEQUENTLY DESIGNATED AS FEDERAL ENTERPRISE ZONES. THIS PROVISION RECOGNIZES THE INITIATIVE OF THE MANY STATES THAT HAVE PASSED OR ARE CONSIDERING STATE ENTERPRISE ZONE LEGISLATION, AND THE BUSINESSES THAT ARE OR WILL BE OPERATING THEM.

THE ADMINISTRATION'S PROPOSAL DOES NOT CONTAIN A PROVISION THAT I BELIEVE IS NECESSARY TO ATTRACT START-UP CAPITAL FOR SMALL BUSINESSES TO LOCATE IN A ZONE. S. 98 INCLUDES A PROVISION TO GENERATE THAT START-UP CAPITAL BY GIVING INVESTORS AN INCENTIVE -- CALLED EQUITY EXPENSING -- TO PURCHASE STOCK IN AN ENTERPRISE ZONE.

EQUITY EXPENSING WORKS MUCH LIKE AN INDIVIDUAL RETIREMENT ACCOUNT (IRS). AN INVESTOR CAN EXPENSE (WRITE-OFF) UP TO $100,000 A YEAR OF THE AMOUNT PAID TO BUY STOCK IN AN ENTERPRISE ZONE SMALL BUSINESS HAVING A NET WORTH OF LESS THAN

$2 MILLION. LIKE AN IRA, THE INVESTOR MUST PAY THE TAX WHEN HE GETS HIS INVESTMENT BACK -- IN THIS CASE BY SELLING THE STOCK. BECAUSE EQUITY EXPENSING ONLY DEFERS TAXES, IT IS A STRONG INCENTIVE TO KEEP THE CAPITAL INVESTED, AS WELL AS AN INCENTIVE TO MAKE THE INITIAL INVESTMENT. I FIRMLY BELIEVE THAT EQUITY EXPENSING -- OR AN EQUALLY EFFECTIVE INCENTIVE -- IS VITALLY NECESSARY.

WHILE THESE DIFFERENCES ARE SIGNIFICANT, THE FOUNDATION HAS BEEN LAID FOR BUILDING RESPONSIBLE, EFFECTIVE ENTERPRISE ZONE LEGISLATION. I PLEDGE MY CONCERTED EFFORTS AND CONTINUED DEDICATION FOR ENTERPRISE ZONES. I URGE THE FINANCE COMMITTEE TO ACT QUICKLY AND FAVORABLY AND JOIN OUR COLLEAGUES IN ENACTING ENTERPRISE ZONE LEGISLATION THIS YEAR.

THANK YOU MR. CHAIRMAN.

The CHAIRMAN. I think Senator Bradley is a cosponsor of the legislation, and there is strong bipartisan support. There have been indications this morning of that. We are, of course, pleased for your efforts, pleased that you could testify again today.

I have no questions, Senator Boschwitz.

Senator BRADLEY. I have no questions. I just want to reassure Senator Boschwitz that the committee is aware that this kind of concept does apply to the areas such as the Iron Range that he has mentioned that have very serious unemployment, and I think that is one of the reasons it has such broad support.

Senator CHAFEE. Yes, Mr. Chairman, I would just like to say that Senator Boschwitz has been a real leader on this issue. He has been persistent and he has testified before this committee several times on this matter. He has given a lot of constructive help and assistance in the whole area. If this legislation passes, it will be due in substantial measure to the work that Senator Boschwitz has done.

The CHAIRMAN. Senator Long, do you have any questions?

Senator LONG. I enjoyed the Senator's statement. Thank you very much, Senator.

The CHAIRMAN. Thank you very much, Senator Boschwitz. We do appreciate your leadership in this area and we will be consulting with you because we have made it clear to the Secretary this morning, Secretary Pierce, that we intend to move rather quickly on this legislation.

We have a problem because it is a revenue bill and there is a little matter of the Constitution that might impede our progress—we do look at that from time to time.

Thank you, Rudy.

Senator BOSCHWITZ Thank you.

The CHAIRMAN. Thanks also for your help on withholding. [Laughter.]

Now we are pleased to hear from Doug DeGood, the mayor of Toledo, and others who are accompanying the mayor.

STATEMENT OF HON. DOUG DeGOOD, MAYOR, TOLEDO, OHIO, ON BEHALF OF THE CITY AND OF THE U.S. CONFERENCE OF MAYORS, ACCOMPANIED BY GEORGE W. HAIGH, CHAIRMAN, TOLEDO ECONOMIC PLANNING COUNCIL, AND REUBEN BUMPUS, PRESIDENT, THE R. F. BUMPUS CO., TOLEDO, OHIO

Mr. DEGOOD. Thank you, Mr. Chairman. It is a pleasure to be here today. It is nice to see you again and I would like again to take this opportunity to thank you for spending some of your valuable time in Toledo and getting an opportunity to develop a firsthand overview of what we have done in our enterprise area there in the city of Toledo.

The CHAIRMAN. Just let me mention, which I mentioned a couple of times, and again we are going to hear the story of how that developed with the private sector and the city and bipartisan, nonpartisan, whatever, approach to a problem, and I know when you were talking about the land area, there is a classic case where there is not much land area but where in Toledo they have started an outstanding project and I am certain they are going to complete it.

Mr. DEGOOD. Senator, I think that perhaps I am the witness you have been looking for here this morning. I am carrying three different buckets of water, and with your permission, I would like to have made a part of the record not only my own testimony but that of Congressman Kaptur and that of the U.S. Conference of Mayors as well. That will speed the process along a little bit.

[The statement of Congressman Kaptur follows:]

MARCY KAPTUR
MEMBER
9TH DISTRICT, OHIO

COMMITTEES
BANKING, FINANCE AND
URBAN AFFAIRS
VETERANS' AFFAIRS

1830 LONGWORTH BUILDING
WASHINGTON D C 20515
(202) 225-4146

FEDERAL BUILDING
234 SUMMIT ST ROOM 719
TOLEDO OHIO 43604
(419) 259-7500

Congress of the United States
House of Representatives
Washington, D.C. 20515

April 21, 1983

The Honorable John H. Chafee
Chairman
Savings, Pensions & Investment
Policy Subcommittee
221 Dirksen Building
Washington, D.C. 20515

Dear Senator Chafee:

In conjunction with the testimony of Mayor Doug DeGood of Toledo, Ohio, and Mr. George Haigh, representing the Toledo Economic Planning Council, I would like to submit the following statement for the record.

We in Toledo are in a particularly advantageous position to comment on the pending Urban Enterprise Zone legislation before your subcommittee. The State of Ohio has already adopted its own Enterprise Zone legislation and the Warren-Sherman project in Toledo has been designated a zone under Ohio's program. While the package of tax incentives provided by the State has helped us in Toledo to begin revitalization in the Warren-Sherman area, greater assistance is essential if the goals of the legislation to attract new business, jobs, and opportunities for the area are ever to be realized.

Assistance in the form of companion federal Enterprise Zone legislation offers useful possibilities. Federal assistance will have a much greater effect on business location decisions and economic renewal prospects in zones like Warren-Sherman than do the currently available state and local tax incentives. I believe, however, the Administration's restricted proposal falls far short of what is required. In order for Enterprise Zones to contribute to the economic revival of depressed cities, a number of other provisions need to be included in the proposed legislation.

The Adminstration's initiative is the least acceptable of the Enterprise Zone alternatives before your committee. Both the Hart and Boshwitz proposals, for example, provide important equity expensing provisions which are critical in making available important up front capital for small businesses. Of the Senate Enterprise Zone options, the Hart bill is the best approach.

An Enterprise Zone program based entirely on tax incentives will have little more effect than providing relief at the margins regardless of the specific objectives of the program. Indeed, the problems of a zone are trivialized if we consider them only a function of tax and regulatory barriers. In order for Enterprise Zone legislation to be effective, it must be linked to a number of other efforts, as well.

Examples of necessary linkages include complementary housing and economic development initiatives, crime control, job training, and infrastructure repair. If the Warren-Sherman project does not succeed,it will be due to the lack of assistance in these significant areas. In addition, such an important undertaking requires a coordinated approach involving business and community leadership development from the affected areas themselves. The City of Toledo and the Toledo Economic Planning Council are to be complimented for their initial efforts to catalyze such activity. Thus, the overall level of assistance necessary to achieve the goals of the Enterprise Zone program throughout the nation cannot be achieved by relying on existing, uncoordinated programs at current funding levels. To think otherwise is to be unrealistic.

Mr. Chairman, you and the members of the subcommittee are involved in an important undertaking. Those of us who want to see the Enterprise Zones succeed, and who believe strongly in public-private-community sector partnerships, are looking to you to revise and redirect the federal proposal in a more coordinated manner in a way that will allow it to succeed in meeting the pressing economic development needs of our community.

Sincerely,

Marcy Kaptur

MARCY KAPTUR
Member of Congress

MK/mvm

Mr. DeGood. I would like also to introduce at this time the two gentlemen with me. On your extreme left is Mr. George Haigh, president and chief executive officer of the Toledo Trust Co. Seated next to him is Reuben Bumpus, a contractor from the city of Toledo and one who has been deeply involved in our inner city rehabilitation efforts.

The city of Toledo simply took the most depressed area in the community in an economic and demographic sense and undertook the revitalization of that area. With the tools at our disposal currently, those being state enterprise zone, tax abatements, tax increment financing, urban development action grants and so on, we have succeeded in creating 300 full-time jobs and 100 part-time jobs.

But as was made quite evident by the testimony of the individuals from Treasury just a few moments ago, it is contemplated that the Federal incentive in these bills would be some fourfold in terms of their impact over the incentives available to State and local governments today. It is because of that reason that we very desperately need this legislation passed.

I won't dwell at any greater length on the Toledo experience because the other two gentlemen can do that very adequately.

I think to some degree the testimony offered by Secretary Pierce and the gentleman from SBA a little bit earlier this morning were contradictory in nature. Secretary Pierce was arguing that the tax incentives currently contained in the Administration's bill are sufficient.

I think some of the gentlemen from SBA were really questioning whether there was sufficient incentive in there to cause investment by small businesses in these enterprise zones. And as one who comes from a community with 14 percent of its people unemployed, I am very seriously concerned about that unemployment problem, and I think that what we have to do here is focus on the creation of jobs, whether those jobs come from a Fortune 500 company or whether those jobs come from what has previously been a cottage industry in the area and has the potential to create some additional employment in the enterprise zone.

So I think that whole debate which we have heard here this morning about who is going to end up in these zones is really reflective of the discussion which Mayor Voinovich alluded to earlier that has taken place in various workshops and study sessions around the country as this issue has been debated for the past couple of years.

The answer to that lies in how the bill is structured. I think for the bill to have the maximum positive effect of creating the greatest number of additional jobs, we are going to have to have the kind of incentives that are currently before the Congress to create that venture capital for some of these smaller businesses to be able to flourish and prosper in enterprise zones.

In addition to that, because of the constraints on municipal budgets, I think it is furthermore imperative that we do have some assistance from EDA in order to enable us to better finance either revolving loan funds to be of assistance to those small businesses coming on board or to deal with the infrastructure questions in those urban enterprise zones.

But I think that the Administration's bill clearly is a positive step in the right direction. It gives us a framework within which to work and I think that with the addition of the incentives for capital formation for small business and the inclusion of some Federal funding to the municipalities involved, we can have a workable strategy here and put some of our people back to work in the cities of this country.

With that I would like to, if I could, Senator, defer to Mr. Haigh for his statement.

[The two statements of Mr. DeGood follow:]

STATEMENT OF
HON. DOUG DEGOOD
MAYOR OF TOLEDO
BEFORE THE
SUBCOMMITTEE ON SAVINGS, PENSIONS AND INVESTMENT POLICY
U.S. SENATE COMMITTEE ON FINANCE

WASHINGTON, D.C.

APRIL 22, 1983

Mr. Chairman, I thank you and the Committee for the opportunity to appear before you again this morning to discuss enterprise zone legislation.

When I last appeared here, in 1981, Toledo's enterprise zone was a concept shared by many sectors of our community.

Today it is a reality. Jobs have been created, shops and factories built and workers trained. The neighborhood has been designated as Ohio's first state enterprise zone.

When I testified here in 1981, enterprise zone legislation was also just a concept - one that provided some promise for helping our nation's cities.

Today, unfortunately, enterprise zone legislation is still just a concept. Its promise remains unfulfilled.

In this brief statement I will seek to bring the committee up-to-date on the status of Toledo's enterprise zone, discuss the need for federal enterprise zone legislation and comment on proposals on this topic now before Congress.

Mr. Chairman, Toledo's enterprise zone is in the neighborhood we call Warren-Sherman. Because it is adjacent to Toledo's downtown, City government, the business community and neighborhood groups have agreed that a coordinated effort to save Warren-Sherman is essential to the success of the City's overall rebuilding plans.

Since 1981, when most of Warren-Sherman's development was just on the drawing board, substantial progress has been made towards the revitalization of the area.

Other testimony you will hear today will give a history of recent developments in Warren-Sherman. My focus as Mayor of Toledo is on our progress in creating jobs and on the need to bring the federal government into the job creation process.

In the last two years, more than 300 permanent full-time jobs have been created in Warren-Sherman. Most of these are in small firms which employ community residents. In addition, 100 part time jobs have been created as part of a state-funded job training program at a neighborhood high school.

Faced with a record of success like this, you could ask us why we need a federal enterprise zone if we are doing so well without it.

First of all, we need to do more to increase employment. In a city where unemployment hovers around 14% we can never look at our work and say "We've done enough."

Second, the gains we have made will be jeopardized if we do not continue to make progress.

As an illustration of my concern, allow me to share with you some of the disappointments we have experienced lately. These problems are due, in part, to the lack of additional aid from the federal government for our enterprise zone.

Perhaps most striking is a housing project which has fallen through. This project would have constructed 235 units of housing and provided assistance for zone residents to purchase the units. Funding was to come in part from a UDAG grant which was approved in 1982. The developer's financing package has dissolved since the UDAG was approved. At present, plans to build the housing are being held in abeyance.

We have also had two manufacturing firms pull out of earlier commitments to locate in the zone. Both of them are Fortune 500 companies which have headquarters in Toledo.

We are working hard to make sure these setbacks do not become a trend. However we cannot do it ourselves. More than just state and local funds and tax breaks is needed to ensure the success of the Warren-Sherman neighborhood.

This committee has before it a range of proposals which will be very helpful to cities seeking to rejuvenate their most distressed neighborhoods. Although the different bills are close to the original enterprise zone legislation, they do address some of the problems I pointed to with other mayors in 1981.

Two years ago, we had four principle problems with existing enterprise zone legislation.

First was the concern that enterprise zones might be viewed as a substitute for federal grant programs then in existence.

Second, we questioned how the program would work without direct aid for infrastructure repair and site preparation.

Third, the lack of start-up capital for small business raised a question about the value of enterprise zones to the types of firms which are the most labor intensive.

Fourth, the program would not touch enough cities to have a real impact across the country.

Now, introduced in the 98th Congress are three major pieces of enterprise zone legislation and other economic development legislation which address all of these problems.

The problems of start-up capital and size of the program are addressed in two bills on enterprise zones. Sen. Boschwitz has introduced legislation (S. 98) which would provide start-up capital for small firms by allowing investors in the firms to deduct the value of stock they purchase in an enterprise zone small business. Sen. Hart's Community Assistance Revitalization Act - called CARA - would provide two mechanisms to generate up-front capital: equity expensing and deductions for small business debentures.

Our concern over the number of zones is partially addressed in the CARA bill, which calls for 165 zones as compared to 75 in other bills.

The other two issues - direct assistance and the substitution problem - cannot be addressed by the Committee on Finance. However, there is legislation in Congress which solves these problems in large part. This legislation would revitalize programs of the Economic Development Administration by targeting them more narrowly than before on cities in distress. Congressman Oberstar has introduced the bill in the House and Senator Mitchell has a similar proposal pending in the Senate.

This EDA legislation is similar to enterprise zones in many ways. It targets aid on severely distressed areas. It is not an entitlement; eligible localities must compete for grants. It is limited in scope - $500 million per year for four years. Finally, it requires a heavy local commitment - 50%.

Legislation like this, if passed in conjunction with enterprise zones would round out a unified economic development program for distressed cities: grants to prepare sites and buildings and meaningful tax breaks which will allow small businesses to generate capital.

It is my hope the committee will explore ways to link enterprise zone legislation with one of the economic development bills in Congress.

In closing Mr. Chairman, I am reminded of a saying from the banking business: "When you lend someone money, be sure you lend them enough."

The Enterprise Zone legislation introduced by the Administration is not enough to generate jobs in Toledo or elsewhere. Other enterprise zone proposals before the subcommittee would greatly improve upon the original enterprise zone concept. Adding the tax incentives to a modest grant program would give us the tools to make enterprise zones do what they are meant to do: bring business, and most of all, jobs to our cities.

UNITED STATES CONFERENCE OF MAYORS
1620 EYE STREET, NORTHWEST
WASHINGTON, D.C. 20006
TELEPHONE: (202) 293-7330

TESTIMONY OF

THE HONORABLE DOUGLAS DeGOOD
MAYOR, TOLEDO

on behalf of
THE U.S. CONFERENCE OF MAYORS

before the

SENATE FINANCE COMMITTEE

on

ENTERPRISE ZONES

April 22, 1983

Mr. Chairman, Members of the Finance Committee, thank you for this opportunity for the U.S. Conference of Mayors to testify on enterprise zones, a subject of considerable interest to Mayors around the country.

First, let me commend Senator Chafee and Senator Boschwitz, along with Senator Hart, for their leadership in sponsoring enterprise zone legislation. The U.S. Conference of Mayors has long been supportive of the concept which underlies enterprise zone legislation, namely, the use of tax incentives to encourage investment and job creation in distressed urban areas. At our annual meeting last year, the Conference of Mayors adopted a comprehensive resolution on enterprise zones which urged the enactment of legislation with the following characteristics:

- Special help for small businesses and new ventures through loan assistance, refundable tax credits, and incentives to encourage financial institutions to make loans in enterprise zones;
- Linkages between enterprise zones and other development activities, with additional funding for training, EDA, UDAG, Community Development Block Grants, and other programs in distressed areas;
- Encouragement of state involvement in and commitments to an enterprise zone, but without absolute state veto over the creation of a zone; and
- Strong and effective employment incentives that more than balance investment incentives within the zone.

I have attached a copy of the full policy resolution at the end of my statement.

The Conference of Mayors is pleased that the Administration has embraced the concept of enterprise zones, and has sent its legislation to the Congress. Over the last two years, we have worked with HUD in drafting their program. However, not all of our recommendations were incorporated into the bill, and consequently we still have several concerns about the Administration's enterprise zone legislation.

First, the Administration provides no special assistance or support for new businesses. In fact, their approach drops a tax incentive, encouraging banks and other investors to make loans to businesses in enterprise zones, which was included in the 1981 version of the Kemp-Garcia bill, and which the Conference of Mayors supported. In a time of high interest rates, one of the most significant impediments to the startup of new businesses is the lack of access to the private capital markets. Thus, we have urged that the Administration and the Congress establish a "new venture fund" for small businesses in an enterprise zone, as has been done by some of the states which have enacted enterprise zone legislation. Moreover, we also continue to support refundable tax credits, which provide some relief to new enterprises, as well as management and technical assistance to fledgling enterpreneurs. I believe that Senator Hart's legislation (S.634) does more than the Administration bill to provide special assistance to new ventures and enhance the access of such businesses to low-interest capital.

Secondly, Mayors continue to support the coordination of the tax incentives in the bill with other federal programs, including economic and community development, training programs, management and technical assistance for small businesses and other appropriate assistance programs. In this regard, we are pleased that enterprise zones would be linked with the creation of Foreign Trade Zones, and the continued use, without restriction, of industrial development bonds. However, we believe that enterprise zones should be part of a much broader economic development strategy for assisting distressed areas.

It is unfortunate that many of the programs that should be tied in some way to enterprise zones have been eliminated or severely curtailed under the Reagan Administration's FY82 and FY83 budgets, including CETA training activities, economic development programs, assisted housing programs, adult and vocational education programs, and urban parks. The Conference of Mayors hopes that this Committee and the Administration will not view enterprise zones as a substitute for proven, ongoing federal programs.

Third, the Conference of Mayors opposes legislative language which would , in essence, require state and local governments to give HUD a guarantee that they will honor their commitments, or "lock in" their commitments before winning an enterprise zone designation. Such guarantees have never been given by the federal government and indeed are out of place in a governmental and democratic context.

Fourth, we are concerned that HUD resist the temptation to impose its values and priorities on local governments, in terms of the commitments they must make if they are awarded one of the 13-25 zone designations. It is important that local governments have substantial flexibility in designing their commitment to an enterprise zone. After all, local officials and citizens know best what incentives are needed in their community to attract business investment and jobs -- whether regulatory changes, service increases, infrastructure improvements, or tax cuts. HUD officials have reassured us that they will exhibit an "open mind" in evaluating state and local applications, and we are hopeful that they will do so. However, over the last year, in many of the materials accompanying this bill, the Administration has spelled out the types of commitments which they will favorably consider -- e.g., changes in zoning ordinances, occupational licensing, economic development planning, the contracting out of services to the private sector, and the creation of neighborhood enterprise associations. These changes may not be appropriate in some cities, whereas others, like crime control, may be extremely important. We would urge this Committee, if an enterprise zone program is enacted, to request that HUD submit to the Congress for its prior approval the proposed criteria for designating zones before any zone designations are made. This will at least ensure that there is some openmindness about the process on the part of HUD.

Fifth, we are concerned about the ability of the state to "veto" the creation of an enterprise zone. While the Conference of Mayors recognizes the importance of the state making a financial commitment to an enterprise zone, we do not believe it is sound or effective federal policy to *require* that the state must submit the enterprise zone application along with the local government, nor to *require* a state commitment. As you all know, the nature of the political process in some states may result in no enterprise zone designations, however distressed the area may be. Some governors and state legislatures have never been very sensitive to the needs of distressed areas, and view any kind of targeting with anathema. Moreover, many state legislatures meet irregularly or at long intervals, which means that the formulation of the state commitment within a short period of time may be technically impossible. Thus, by mandating a state role, however desirable and important it may be, many cities will be precluded from participating in the enterprise zone program.

One final point concerns us. The Conference of Mayors believes that the most important objective of enterprise zone legislation is to create jobs in distressed areas. On this score, I am uncertain whether the package provides enough employment incentives, however generous they may appear to be. For example, most of the investment incentives -- the additional investment tax credit and the elimination of capital gains -- may be more attractive financially to many firms than the additional employment incentives. The result may be investment in labor-saving machinery which translates into a net *loss* of jobs or the "selling-out" by firms which have been in the area a long time and decide to avail themselves of the capital gains incentive. Clearly, this whole area of the efficacy of employment incentives versus incentives, needs to be examined in more depth.

Mr. Chairman, I thank you for the opportunity to present the views of the U.S. Conference of Mayors on enterprise zones. We fully support and sympathize with the Administration's and this Committee's goal of creating new investment and jobs in distressed urban areas, and we commend you for your openness to the views of Mayors and the other officials who must make enterprise zones work.

In view of the many reductions which have been made in urban programs and the desperate fiscal straits of many cities, I hope this Committee will move quickly to enact an enterprise zone bill. The Conference of Mayors looks forward to working with you and the Congress on this and other tax legislation to encourage investment and job creation in distressed urban areas. Thank you.

RESOLUTIONS ADOPTED

Fiftieth Annual Conference

Minneapolis/Saint Paul, Minnesota
June 19-23, 1982

Enterprise Zones

WHEREAS, the Administration has proposed an experimental program to create up to 75 enterprise zones over three years in distressed areas; and

WHEREAS, Republicans and Democrats in the Congress have supported enterprise zone legislation for two years, and worked with mayors to draft an acceptable and effective program; and

WHEREAS, enterprise zones, if properly designed and implemented, promise much needed help to poor urban areas; and

WHEREAS, tax incentives, in and of themselves, are of limited effectiveness in stimulating investment and employment; and

WHEREAS, the Administration bill does not include any special help for small business or new ventures or any linkages between enterprise zones and other federal development and training activities, and reflects some distrust of state and local governments; and

WHEREAS, one of the principles of the Urban Enterprise Zone legislation is that "Enterprise Zones should go to those communities which are willing to make the greatest commitment for restoring investments for job creation;" and

WHEREAS, the U.S. Conference of Mayors has long supported tax legislation to target special and more generous tax incentives to distressed urban areas,

NOW, THEREFORE, BE IT RESOLVED that the U.S. Conference of Mayors supports the enactment of an enterprise zone program with the following characteristics:

- special help for small businesses and new ventures through loan assistance, refundable tax credits, and incentives to encourage financial institutions to make loans in enterprise zones;
- linkages between enterprise zones and other development activities, with additional funding for training, EDA, UDAG, Community Development Block Grants, and other programs in distressed areas;
- flexibility on the part of HUD with respect to the types of local incentives to be made available in the zone;
- recognition by HUD in reviewing applications of any past efforts by cities and states to target assistance to the enterprise zone;
- encouragement of state involvement in and commitments to an enterprise zone, but without absolute state veto over the creation of a zone;
- a larger experimental program than that proposed by the Administration to ensure that many approaches are tried and that there is nation-wide support for the creation of an enterprise zone program;
- elimination of any requirement that the local government "lock in" or guarantee its commitments or be liable to legal suits by zone residents and businesses;
- strong and effective employment incentives that more than balance investment incentives within the zone; and
- careful consideration to the provision of a federal financing plan, in connection with enterprise zone legislation, which realistically addresses local governments' reliance on real property revenues to maintain this country's quality of life.

The **Chairman**. Mr. Haigh?

Mr. **Haigh**. Thank you, Mayor and Senator Dole.

I would like to commend this committee for returning to this issue once again. I think much has been learned since the hearings that were held several years ago, and I would hope that it brings a better perspective on what congressional response might be as we address this legislation once again.

In some ways, this delay may have been helpful because we have learned some more things. In our case the additional progress since 1981, in what we call our Warren-Sherman urban development area warrants an updating to you since I testified in 1981.

I think there are at least four principal factors in the restoration of the viability of this area: The comprehensiveness of the redevelopment strategy; the combination of interests that were brought together by that strategy; involvement by the neighborhood itself; and, of course, assistance from the Federal government.

The most important of these four factors is really the comprehensive approach to the project. It was recognized at the inception of the Warren-Sherman project that the ability to effectively coordinate economic, social and physical improvements was a mandatory requisite if there was going to be success.

Another major factor contributing to the success of this project is the combination of interests which have worked and are continuing to work to make the plans on paper realities on the ground.

Senator **Chafee**. Mr. Haigh, we have a time problem here this morning so I think what would be most helpful to the committee would be for you to tell us what you think we should add to this legislation. or what should be taken out.

Mr. **Haigh**. OK, Senator.

I believe basically, having been here before and testified, that the things that we said in the record of 1981 mostly have been accomplished. But, I continue to believe and firmly support the idea of some understanding and recognition of the fact that these zones are at high risk for investors.

I believe that there has to be a recognition of some form of incentives that can be made beyond the tax benefits, because in our experience, it has been very difficult to get people to invest in there. You have all the destabilizing things that one knows, and I think if we can remove more and more of what I call the upfront risk that comes when you give rebirth to a community, you will tend to find people coming in.

I do not worry about abuse. We have had great success throughout this Warren-Sherman area in a variety of ways. We have made the center of this the control of how employment is done, who gets the employment. And we have several smaller companies wanting to come in. We know how to address that. But there has to be some recognition, beyond UDAG, beyond the EDA help that we had in the early months of this, that tax benefits, by and of themselves, in my mind are not sufficient.

If we can understand that and accept that, we can bring the kinds of needed employment levels to these zones.

We have over 600 people that are now employed. The bulk of those people were on welfare. The Treasury is better off today; the government is better off today because of what we have done so far. We are living evidence that you can do something and you can benefit the government.

I think that with more help, such as this zone legislation, we can complete, hopefully, what we have started. Thank you.

[The statement of Mr. Haigh follows:]

STATEMENT OF GEORGE W. HAIGH, CHAIRMAN, TOLEDO ECONOMIC PLANNING COUNCIL, BEFORE THE SUBCOMMITTEE ON SAVINGS, PENSIONS AND INVESTMENT POLICY, SENATE COMMITTEE ON FINANCE, WASHINGTON, D. C., APRIL 22, 1983

It has been almost two years since this Committee held its 1981 hearings on this subject. Much has been learned since then, including more about what these zones really do need. It also includes a better perspective on what the response might have to be to those needs in order to assure enactment.

Toledo's existing enterprise zone is in the Warren-Sherman neighborhood. It is our successful effort to revitalize a severely depressed inner-city neighborhood. It is an enterprise zone because it has been designated as Ohio's first under our State statute. This project's principal goal is the restoration of economic and social stability to a neighborhood that is characterized by high unemployment, poverty and public welfare dependency, blighted housing, inadequate job opportunities and other indicators of urban decay. Conditions are sufficiently better in Warren-Sherman today for us to believe that the comprehensive redevelopment strategy underlying that betterment is working. It is in this respect that we believe that it is an excellent model for enterprise zone development.

The Federal role has been crucial to the success of this zone, and it will continue to be. Without the Federal component, Warren-Sherman could collapse, for the elements of its strength remain at a crucial stage. Additional tax incentives will be needed. So too will other forms of direct and indirect assistance: economic development grants, targeted jobs training, etc. It is a reality, however, that the likelihood of the enactment of this enterprise zone legislation by the full Congress may depend on how it is coupled with these other elements.

The enterprise zone legislation is not without its critics. It is our opinion that these criticisms will have to be answered in order to attain enactment of the legislation. We believe there are constructive ways to proceed. For example:

(1) The Administration's bill (S. 864), Sen. Hart's bill (S.634), and Rep. Oberstar's National Development Investment Act (H.R. 10) all adopt some form of designated area concept. The number of areas to be designated differ inconsequentially during the first three years.

(2) While the Administration's bill provides most tax incentives for employers and the Hart bill provides most tax incentives for employees, they complement one another.

(3) The Oberstar bill provides important means of dealing with the question of a severely limited number of zones to be designated.

(4) The Administration might be able to win support for one or more provisions of its proposed Employment Act of 1983 (S. 1023, by Sen. Dole), if it accepted the "development strategies" provisions of the Oberstar bill.

These proposals would expand the program contemplated. In the final analysis, however, the question is whether we let the fear of static revenue losses and reasonable levels of additional appropriations drive us into destroying a major source of hope on one hand and a very workable program to genuinely revitalize urban areas on the other.

STATEMENT OF GEORGE W. HAIGH, CHAIRMAN, TOLEDO ECONOMIC PLANNING COUNCIL, BEFORE THE SUBCOMMITTEE ON SAVINGS, PENSIONS AND INVESTMENT POLICY, SENATE COMMITTEE ON FINANCE, WASHINGTON, D.C., APRIL 22, 1983

Mr. Chairman and Members of the Committee:

I am George W. Haigh, chairman of the Toledo Economic Planning Council.

I appear before you today in support of the early enactment of S. 863, the proposed Enterprise Zone Act of 1983, and of provisions of complementary economic development and jobs creation and training bills.

I appear in this matter on behalf of the Toledo Economic Planning Council (TEPC), which is the non-profit development corporation charged with the responsibility of harnessing resources in and for Toledo's existing enterprise zone; the businesses, small and not-so-small, which have located in the zone and created jobs there; and Toledo Trust Company, of which I am also president and chief executive officer, the principal financial supporter of the project.

This Committee is to be commended for returning to this issue in this new Congress. It has been almost two years since this Subcommittee held its 1981 hearings on the enterprise zone concept and on legislation designed to make it a reality for up to seventy-five areas throughout the country.

Much has been learned since the 1981 hearings. That learning includes more about what these zones really do need from the Federal Government. It also includes a better perspective on what the Congressional response might have to be to those needs in order to convince the House of Representatives of the worthiness of this legislation.

In many ways it is because of the two year delay in enacting this legislation that I requested to appear before you again. I testified in 1981, and TEPC had thoughts to offer this Committee then. The additional progress since 1981 in Toledo's Warren-Sherman urban development area warrants an updating of the facts and the lessons to be extrapolated from them.

The Warren-Sherman Enterprise Zone

The Warren-Sherman enterprise zone is Toledo's successful effort to revitalize its most severely depressed inner-city neighborhood. Warren-Sherman is the name of that neighborhood, and we refer to it today as an "enterprise zone" because it has been designated as Ohio's first under our State statute. This project's principal goal is the restoration of economic and social stability to a neighborhood that is characterized by high unemployment, poverty and public welfare dependency, blighted housing, inadequate job opportunities and other indicators of urban decay.

Conditions are sufficiently better in Warren-Sherman today for us to believe that the comprehensive redevelopment strategy underlying that betterment is working. It is in this respect that we believe that it is an excellent model for demonstrating to the nation how an enterprise zone can work.

The Warren-Sherman project has attracted considerable national, and even international, attention. Coverage about it has appeared in "Time" magazine, "Fortune," "The New York Times," "Nation's Business," and "Dunn's Business Month." In addition to this Committee, the Joint Economic Committee and the House Committee on Banking, Finance and Urban Affairs have heard testimony in respect to it. Of particular note, the cities of Miami, Florida; Pittsburgh, Pennsylvania; St. Louis, Missouri; Atlantic City, New Jersey; Portland, Oregon; Fayetteville, North Carolina; Springfield, Ohio; South Bend, Indiana; Easton, Pennsylvania; Des Moines, Iowa; Chicago, Illinois; and Amsterdam have toured it or drawn directly from its experience. In addition, during Senator Dole's visit to Toledo on February 19, members of the Committee on Finance staff involved with this issue toured the zone.

There are at least four principal factors in the restoration of the viability of this area: (1) the comprehensiveness of the redevelopment strategy, (2) the combination of interests brought together by that strategy, (3) involvement of the neighborhood itself and (4) assistance from the Federal Government.

I think it would be beneficial to this Committee to examine each of these factors.

Comprehensive Redevelopment. The most important of the four factors is the comprehensive approach of the project.

Previous experiences in urban revitalization throughout our country have demonstrated the futility of one-dimensional attempts to deal with urban development problems. It was, thus, recognized at the inception of the Warren-Sherman project that the ability to effectively coordinate economic, social and physical improvements was a mandatory requisite of success. Consequently, this project has been oriented toward viable solutions to a wide range of problems. It addresses jobs creation and jobs training, enterprise development, redevelopment of commercial services, health care, day care, recreation and other social support services.

Jobs creation was of the most immediate concern, since little impact could be expected from other efforts without employment opportunities for the neighborhood residents. We felt jobs would have to be closely matched with the abilities of the residents and that jobs training programs were essential to the enhancement of those abilities. Some were unskilled, others inadequately skilled and still others skilled for jobs which no longer existed. There has been dramatic improvement in the jobs skills among these residents since the inception of the project, and the Control Data Business & Technology Center and its computer-based training program have had most to do with this improvement.

Support for the development of small businesses was designed into the project, and there has been moderate success in this regard to date. It is here, in fostering the creation and growth of smaller businesses, that much more must be done. I think we should realize, however, that overall national economic conditions affecting smaller businesses have not fostered such creation and growth -- in Toledo, in Ohio, or elsewhere.

It was obvious that significant improvement of the housing stock was a major need. The project included development of substantial new market-rate housing from its inception. It also included new subsidized housing and extensive rehabilitation. Much more must be done in this respect too, and the apparent return of rates of interest to historical norms should assist in this respect.

The neighborhood had no local convenience of commercial services, and in this respect there has been substantial improvement. A neighborhood shopping center of 50,000 square feet has been almost completed.

Health care, day care, and other social services have been dramatically improved since the project's inception.

In summary, the Warren-Sherman project addresses the need to deal with all of the major problems of a blighted urban neighborhood. We know, for sure, that jobs without improved housing, commercial redevelopment and improved social services will lead to further abandonment, for persons will refuse to live in the area where they work. On the other hand, improvements in social and physical characteristics of the neighborhood without providing mainstream economic participation for the residents is unlikely to lead to a viable neighborhood.

The bottom line on this is that, while the coordination of such multiple efforts is difficult, any approach less comprehensive would not be successful.

Combination of Interests. Another major factor contributing to the success of this project is the combination of interests which have worked, and are continuing to work, to make the plans on paper realities on the ground. These interests are the private sector, the public sector and a non-profit developer.

The private sector involvement is led by Toledo Trust Company, Toledo's largest financial institution. It has been instrumental in obtaining private sector support, investment and job commitments, and in arranging financing for various project components. While the bank's willingness to take a lead role and its contacts throughout the business community have been important, it has not stood alone. Owens-Illinois' new corrugated box plant has been built within the zone, and it created new jobs, not relocated ones. Control Data Corporation has made a substantial neighborhood investment in developing the Business & Technology Center to which I have referred.

We cannot overlook the importance of the commitments these larger corporations have made. We refer to it as "anchoring a zone." It is a vitally important thing to have happen and an important concept to understand. Risks have actual and potential costs to businesses, and larger corporations are more capable of assuming risks directly or having their risks shared than are smaller businesses. Assuring security of the physical plant, inventory and work force is but one example. Only when a zone has the framework for such security -- and major corporations' facilities are critical pieces of that framework -- does the economic and emotional security of other businessmen follow. Persons contemplating enteprise zones as block after block of mom-and-pop grocery stores fail to realize this. They should go talk with those moms and pops.

The local public sector is represented by the City of Toledo and its Department of Community Development and more broadly by the State of Ohio. They have taken responsiblity for all public improvements including housing, land acquisitions, and street and utility upgrading. The City's strong support for this project, led by Mayor Doug DeGood, has ensured that available public sector resources have been directed to the project. The commitment of the State of Ohio has been active and has taken two forms: First, State aid for certain aspects of the revitalization of the area and the broader community, and second, enactment of the State statute on enterprise zones under which Warren-Sherman has been designated.

The third partner in this triad of interests is the Toledo Economic Planning Council. TEPC is a non-profit development corporation. It has served as the overall project sponsor, and it serves as the developer of the 23-acre Warren-Sherman Industrial Park. TEPC has served as an important project facilitator by providing a bridge between the public and private sectors, both of which are represented on TEPC's board of directors.

The cooperation of these participants -- the private sector, the public sector and the non-profit development corporation -- has been a principal ingredient in Warren-Sherman's success.

Neighborhood Involvement. The third major factor in the success of the Warren-Sherman area and a critical one is the way in which its residents have participated in this project.

Mr. Reuben Bumpus, president of R. F. Bumpus Company, will address this involvement in his remarks.

1981 and 1983

Mr. Chairman, the hearing record of our July 13, 1981 testimony speaks to the status of the Warren-Sherman neighborhood revitalization project at that time. Much had been done, and much more was planned. Some in Washington may have wondered then, however, just how much of that planning would become an additional reality. Our response is given to you today, and it is, "Much, if not most!"

Let me be specific.

Control Data Business & Technology Center. This Business & Technology Center (BTC) is a small business incubator. It is the heart of our zone. It offers, in addition to industrial and commercial space, a wide variety of services generally unavailable or too costly for small, growth oriented firms. The facility consists of a $7 million investment in a complete rehabilitation of an old 200,000 square foot industrial plant located in the Warren-Sherman Industrial Park.

Today, BTC houses twenty-four (24) new businesses, half of which are minority owned. Those businesses employ 250 people, 80% of whom are minorities and 70% of whom are residents of the Warren-Sherman area. Over 50% of the floor space has been leased too. A list of the present tenants of this incubator facility is a part of my statement at Appendix 2.

Owens-Illinois Corrugated Shipping Container Plant. In 1981, we could only indicate to you that the Owens-Illinois corrugated shipping container plant site had been selected.

This facility opened this month in the zone. It is a new, 50,000 square foot manufacturing facility and it too is located in the new Warren-Sherman Industrial Park. It constitutes an investment of approximately $3 million, and all but one of its present employees are residents of Warren-Sherman.

Magnetic Peripherals, Inc.. In 1981, we told this Committee that Magnetic Peripherals, Inc., a manufacturer of cable and harness assemblies, intended to locate a new operation in Toledo.

Today, it is in the Warren-Sherman revitalization area. It is, in fact, located within the BTC, utilizing about 50,000 square feet of industrial space there. The investment here is approximately $1 million, and it is employing about 115 people, which is more than contemplated in 1981.

The Bancroft-Franklin Shopping Center. You will recall from our 1981 testimony that one of our principal concerns was the lack of retail shopping facilities within the zone, facilities which not only provided badly needed services but which also hired people and generated payroll. In 1981, we were so far away from this project that we did not even yet have a name for it.

Today, the Bancroft-Franklin Shopping Center is nearly complete. The grand opening of this 50,000 square foot facility will be in June. The shopping center will house a grocery store, a hardware store, a laundromat, a fish market and a half-dozen other shops.

Toledo Trust Company arranged the financing for this shopping center, and as an additional act of our commitment and faith in its future, we did so at less than market rates of interest.

Warren-Sherman Management and Maintenance Company. When we testified in 1981, we had only the concept that a property management and maintenance services company would be needed in respect to the industrial park, the shopping center, the residential developments, etc. We knew we thought it should be minority owned and managed, and that it should be a for-profit corporation.

In 1983, the Warren-Sherman Management and Maintenance Company is an Ohio corporation. It has contracts with the BTC, the industrial park and a branch of Toledo Trust Company. It provides general maintenance, as well as snow removal, lawn mowing, etc.

The company is now adding security forces and strengthening itself by entering into contracts to provide similar services outside the zone, specifically in the waterfront redevelopment area of Toledo.

Training Programs. Over 850 students will have received computer-based remediation and skills training by the end of 1983 through the Scott High School Training Program. Many of these students have already been released from full-time participation in the training program and are working half days with for-profit businesses in the zone.

Other. Much more than those specific hallmarks of progress which I have just noted have occurred within the Warren-Sherman area. These include small businesses, new commercial and service facilities, improved housing, health care and day care. In this respect, a current status report on Warren-Sherman is made a part of this statement as Appendix 1.

An Invitation. We take the opportunity of these hearings to invite any and all persons with an interest in the enterprise zone concept in general and Warren-Sherman's successes in particular to come to Toledo to tour the zone, to meet with its leadership, and to learn from its experiences. There are only a small handful of existing areas throughout the country which have demonstrated that they will succeed, and Toledo is one of them and, in that context, a model for others.

Our invitation extends to Members of Congress and their committee and legislative staffs, to officials within the departments and agencies, to other cities, etc.

This Enterprise Zone in Context. It should be noted that what they will see is how a broader community can help a zone and how a zone can help that broader community.

An enterprise zone, a revitalization area, or whatever one wishes to call a project such as Warren-Sherman does not stand in isolation. Its redevelopment is essential to the growth of areas around it, as is the growth of those areas to the future of the zone. Toledo is experiencing a significant redevelopment, in spite of its continuing problems with business relocations to areas outside of the region and the loss of jobs from that, and with a general decline in the part of the economy associated with automobiles. Unfortunately, this includes nearly every principal industry in Ohio: steel, rubber, glass, automotive manufacturing itself, as well as other component parts manufacturing. Yet our waterfront is being totally redeveloped, and that includes the

Owens-Illinois new world headquarters, the new Toledo Trust headquarters and a waterfront development, known as Portside, by the Enterprise Development Company, headed by nationally known developer James Rouse. It is our belief that each will reinforce the other, providing jobs, income, tax revenues, etc.

Warren-Sherman as a Lesson: The Role of the Federal Government

In announcing these hearings, Senator Dole stressed his particular interest in receiving testimony on the criteria to be used in designating zones, on the effectiveness of tax incentives in stimulating new economic activity in the zones, and on the effectiveness of reducing Federal, State or local regulations as a means of encouraging greater business activity in enterprise zones. I will be responsive to each of those in this statement. It is appropriate, however, to set the Federal role in a context, and I can best do that in relationship to the Warren-Sherman experience.

The Federal Role to the Present. The Federal role to date has been crucial to the success of this zone, and it will continue to be in the future. It is the fourth factor contributing to its success. This Federal role has not been principally that of the provider of tax incentives, although existing Federal tax incentives have most certaily helped. The Federal role to date has been principally through forms of direct assistance, including in particular Urban Development Action Grants (UDAG), and targeted jobs training programs. We have an improved infrastructure in the area of the zone because of

Federal assistance. We have improved jobs skills because of Federal assistance. Yet that assistance has not been necessarily any greater than or any less than any other urban distressed area, for the qualification criteria which apply to one apply to all. Our success has been magnified because we have, we believe, more consciously applied the resources provided by the Federal Government in a more targeted, and therefore a more careful, way.

The Federal Role in the Future. The Federal role in the future will remain critical. Without a Federal component, it is safe to say that Warren-Sherman could collapse as a viable undertaking, for the elements of its strengths remain at a crucial stage. Additional tax incentives will be needed. So too will other forms of direct and indirect assistance: economic development block grants, targeted jobs training, etc. It is not the role of the legislation before you nor the subject of your Committee's jurisdiction under the Senate Rules to deal with all the components of what these zones will need. It is a reality, however, that the likelihood of the enactment of this legislation by the full Congress, which includes the House of Representatives, may well depend on how the enterprise zone concept and legislation is coupled with these other elements of Federal assistance.

The enterprise zone concept is not without its critics. Last year, the combination of those critics and those other persons just not really convinced of the need for this legislation precluded its enactment. That is a reality, but it is one which can be avoided in 1983, depending on the leadership given to this concept by those within the Congress, the Administration, State and local government and the private sector committed to its enactment.

The historical record might as well reflect what these criticisms are. I believe they are at least as follows:

(1) How to win support in a national legislative body reflecting development needs in nearly every State and area throughout the country for legislation which is limited to a maximum of seventy-five zones over three entire years;

(2) How to win support for what appears to be principally a Republican measure -- although it is not -- in a House Committee on Ways and Means and a House of Representatives not only of the other party but apparently deeply concerned about the impacts on all cities of the Administration's often drastic budget cuts; and

(3) How to persuade that Administration that there are elements of enterprise zone development beyond tax incentives and a very limited number of other measures, including deregulation, which are essential to assuring their successes.

There are other problems as well.

It is our opinion that these obstacles must be removed or reduced in order to attain enactment of this very important legislation.

We believe there are very constructive ways to remove or reduce these obstacles. For example:

(1) The Administration-proposed enterprise zone bill (S. 863) and the very similar, Sen. Boschwitz-introduced earlier

enterprise zone bill (S. 98), the Sen. Hart-introduced revitalization area bill (S. 634), and Rep. Oberstar's proposed National Development Investment Act (H.R. 10) all adopt some form of designated area concept. Furthermore, the number of areas to be designated under the Administration bill and the Hart bill differ inconsequentially during the first three years.

(2) While the Administration's bill would provide most tax incentives for employers in zones and the Hart bill would provide most tax incentives for employees, these provisions complement one another.

(3) The Oberstar bill provides an important means of dealing with the question of the severely limited number of zones to be designated and to receive assistance, for the Oberstar bill would provide certain assistance to many urban and non-urban areas. Furthermore, that assistance includes funds for "development strategies" which are closely parallel to the planning strategies required for enterprise zone designation. Lastly, the Oberstar price tag is only $500 million each year for four years, a very reasonable sum as budgets go these years.

(4) The Administration might be able to win support for one or more provisions of its proposed Employment Act of 1983 (S. 1023, by Sen. Dole), if it accepted the Oberstar provisions.

Appendix 3 to this statement reflects just how much closer these bills are than many people know or suspect.

These proposals would expand the program contemplated. They would add to the initial costs in terms of static revenue losses to the Treasury and to the initial costs in terms of appropriations. We believe, however, and we find broad support for this, that dynamic revenue gains will offset both. In the final analysis, the question is whether we let the fear of such static revenue losses and reasonable levels of increased appropriations drive us into destroying a major source of hope on one hand and a very workable program to genuinely revitalize urban areas on the other.

I wish to make it clear that these are our ideas. I have not personally discussed this strategy with a single person in the Administration, in the Senate until this testimony, or in the House of Representatives. I am laying out a strategy grounded in logic, not the legislative realities which you must face, but I do believe strongly that if everyone would "give a little here to get a little there" on this important legislation, we would win enactment very soon.

This is our context for examining the provisions of S. 863.

The Proposed Enterprise Zone Act of 1983

Let me address the principal questions Senator Dole raised in his announcement of these hearings.

Designation Criteria. We have analyzed the designation criteria set forth in S. 863 in depth, and while we might quibble in some minor ways, we have no objection to their enactment.

Tax Incentives. We believe this Committee should incorporate in the text of the enterprise zone bill to be reported to the Senate certain provisions of complementary bills.

Foremost among these is a provision, Subtitle E, in S. 98, by Sen. Boschwitz, in respect to a deduction for enterprise stock purchases. This is a matter which Mr. Bumpus will address in detail in his statement.

We also believe the additional incentives for employees found in the provisions of S. 634, by Sen. Hart, are worthy of consideration. Employee participation in equity ownership of businesses is important to harnessing additional commitment of employees to the success of businesses. Further, equity ownership by employees who live and work in these zones will add substantially to their understanding of the issues which the managers face in building these businesses into permanent enterprises.

Lastly, we believe the property rehabilitation incentives and the energy conservation incentives, both for residential and commercial purposes, contemplated in the Hart bill are worthy of your consideration. I do know that both would be helpful to the continued development of Warren-Sherman.

Reducing Over-Regulation. This is an important area, but it goes far beyond the regulation of the Federal Government. We have seen as much, if not more, unnecessarily burdensome regulation as a result of State and local policies, statutes, ordinances, etc. We believe that the reduction of regulation in terms of enterprise zone development is going to be more the purview of State and local governments.

Warren-Sherman and the Future

It could be said, in light of the success to date of the Warren-Sherman project, that it is proof that additional Federal assistance and/or tax incentives is not needed. That is wrong. It reflects a gross misunderstanding of what is required to sustain that success.

The success of Warren-Sherman is not assured. We must still attract a minimum of 1500 new jobs to the zone over the next three years; that is 500 new jobs per year. It is apparent that much more will have to be done as to small business, and it is as apparent that this could be greatly assisted by tax incentives possible within the legislation before you; the proposed enterprise stock deduction is foremost among these. Warren-Sherman does not have good transportation access, and assistance will have to be found to assure it; this could become a severely limiting problem. Because it is located in the core of the inner city, where jobs skills have declined drastically, they will have to be upgraded and/or reattracted to the zone; thus, additional jobs training assistance is mandatory. Lastly, while the zone for which we would seek an enterprise designation under the Federal plan would include the present Warren-Sherman area, it would be larger and therefore different.

The future of Warren-Sherman does, therefore, depend substantially on what this Committee, Senate and Congress can do to get this legislation, hopefully with improving amendments, to the President's desk. We hope that that is at the earliest possible date.

We remain ready to assist in whatever ways are possible.

Thank you.

APPENDIX 1

WARREN-SHERMAN - STATUS REPORT

April, 1983

1. Project - Control Data Business & Technology Center

   Description - A small business incubator, offering in addition to industrial and commercial space, a wide variety of services generally unavailable or too costly for small, growth oriented firms, this project consists of a $7 million investment in a complete rehabilitation of an old 200,000 square foot industrial facility located in the new Warren-Sherman Industrial Park.

   Current Status - The facility opened for business in June, 1981. It currently has 24 new businesses, half of which are minority owned. Fifty percent of the available space is leased.

2. Project - Magnetic Peripherals, Inc.

   Description - This company, a manufacturer of cable and harness assemblies, located a new operation in Toledo, in the Business and Technology Center, utilizing about 50,000 square feet of industrial space. Plans called for an investment of approximately $1,000,000, with 100 employees on board by January, 1982. A substantial number of these jobs are to be held by Warren-Sherman residents.

   Current Status - Currently over 115 employees have been hired.

3. Project - Owens-Illinois Corrugated Shipping Container Plant

   Description - Owens-Illinois will open a new 50,000 square foot manufacturing facility in the new Warren-Sherman Industrial Park. This facility will involve an investment of approximately $3 million, and will employ approximately 20 people initially, most of whom will be Warren-Sherman residents.

   Current Status - Construction of the facility is complete. The plant opened in February, 1983. The work force includes 21 people who were placed through the job bank. Twenty employees are residents of the neighborhood.

4. Project - Warren-Sherman Industrial Park

Description - This 23 acre Urban Industrial Park, being developed by The Toledo Economic Planning Council, will provide sites for approximately 250,000 square feet of new light industrial facilities, and utilizes innovative design techinques because of the urban nature of the park. Tenants will make substantial commitments to the hiring of Warren-Sherman residents.

Current Status - Phase I, consisting of preparation of a parking area serving the Business and Technology Center was completed in 1981. Phase II, consisting of the acquisition of properties, development of parking areas, sidewalks, and installation of informational kiosks and public access areas is basically complete. Six development parcels are available. One has been leased by Owens-Illinois. A program to market the other parcels is underway.

5. Project - Brown Packaging and Bindery, Inc.

Description - This for-profit minority enterprise, whose establishment was assisted by City Venture Corporation and Control Data, provides packaging, binding, and imprinting services. Located in the annex of the Business and Technology Center, this company provides part-time employment to neighborhood residents, and work site experience to participants of the Control Data Fair Break Program.

Current Status - This business has been operating since March, 1981 and currently has 11 employees.

6. Project - Scott High School Training Program

Description - The training program was begun in the Fall of 1981, and offers computer based remediation and skills training. The program is funded by an $800,000 grant from the State of Ohio. Some students have the opportunity to combine their training with on-the-job experience in the Warren-Sherman area. The training center is also being used by the adult education program in the evenings.

Current Status - The program began midway through the 1981-82 school year and enrolled 450 students. Approximately 400 students are enrolled for the 82-83 school year. Since the program began, 100 students have worked part-time at Magnetic Peripherals, Inc. while attending school.

7. Project - Shumaker, Loop & Kendrick

Description - Toledo's largest law firm made a $4.3 million investment in a substantial rehabilitation of an aging commercial facility as a site for their new law offices. Located on the edge of the Warren-Sherman neighborhood adjacent to downtown, this project creates a strong bridge between downtown and the Warren-Sherman revitalization, and greatly enhances commercial property values in the neighborhood.

Current Status - This project was completed in July, 1981, when Shumaker, Loop & Kendrick took possession of their new facility.

8. Project - Warren-Sherman Management and Maintenance Company

Description - This for-profit company, which is owned and operated by the Warren-Sherman Community Council, was formed to provide a wide range of property management and maintenance services to the Warren-Sherman Industrial Park, shopping center, residential developments, and other customers. Targetted initially to Warren-Sherman opportunities, this operation has potential for serving a much larger market.

Current Status - The company has been organized with the assistance of City Venture Corporation. Seventeen employees have been trained through a CETA funded program. Contracts exist with the Business & Technology Center as well as a branch bank for snow removal and other services. The firm is also expanding to include a trained work force of security guards. Contracts are being negotiated for the firm's services at several downtown redevelopment projects.

9. Project - Warren-Sherman Housing

Description - In response to a need for improved housing and increased owner occupancy in the Warren-Sherman neighborhood, a wide variety of housing developments are underway. The initial project involved a demonstration of total rehabilitation and solar technology for a typical neighborhood dwelling, a six-plex. Plans call for rehabilitation of older neighborhood housing, and development of new market rate housing.

Current Status - The solar demonstration rehabilitation is complete, with all six units occupied.

9. Current Status (cont'd)

Discussions are going forward with developers for commitments toward the construction of 235 units of housing in a 17 acre subdivision. Plans in the subdivision call for 31 single-family, detached houses; 108 three and four bedroom townhouse units to be sold as condominiums and 96 garden apartments for market rate rentals, all of which will be assisted by a UDAG interest subsidy program designed to assist neighborhood residents with home ownership. A plan to form a non-profit corporation to sponsor a HUD housing project for the handicapped is proceeding. The plan calls for 40 units of handicapped housing.

10. Project - Warren-Sherman Parental Enrichment Program

Description - This program, located in the Bancroft-Kent neighborhood center, provides a variety of educational services and programs designed to aid young parents and their children.

Current Status - Funding for the initial year of operation has been provided by a grant from the United Way. The facility began operation in March, 1982. Additional funding is being sought to continue the program.

11. Project - Bancroft-Franklin Shopping Center

Description - This is a 50,000 square foot shopping center at the southeast corner of Bancroft and Franklin. It will be anchored by a supermarket and include as other tenants: a drug store, hardware store, clothing store, game arcade, coin-operated laundry, a fish market, card shop, beauty salon, health spa, and several other, tenants. Minority ownership is being encouraged.

Current Status - Construction is scheduled to be completed in May, 1983, with the Center slated to open in June, 1983.

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Current Status - Construction is scheduled to be completed in May, 1983, with the Center slated to open in June, 1983.

12. Project - Bank/Professional Office Building

Description - This will be an 12,500 square foot building at the northeast corner of Bancroft and Franklin Streets in the heart of the Warren-Sherman neighborhood. It will house a full-service Toledo Trust branch bank office with drive-up window, as well as professional offices for attorneys, physicians and other professionals.

Current Status - The City has acquired title and cleared the land and the developers are finalizing equity commitments. Approval has been received by regulatory authorities for the Toledo Trust branch. Construction is scheduled to begin in Spring, 1983. Occupancy is expected by Fall, 1983.

13. Project - Urban Jobs and Enterprise Zone

Description - The State of Ohio has certified an area comprising 1,418 acres having its principal focus on Warren-Sherman as an enterprise zone under Ohio's Urban Jobs and Enterprise Zone Act.

Current Status - In the Fall of 1982, the City of Toledo received the State's first certification which allows the City to negotiate a package of benefits including real property tax exemptions and personal property tax exemptions as inducement to businesses to either expand within or locate in the certified zone. TEPC is marketing and managing the Enterprise Zone of the City of Toledo. The City of Toledo is prepared to apply to the Federal Government for designation as a federal enterprise zone, when such legislation is enacted by Congress.

CONTROL DATA BUSINESS
& TECHNOLOGY CENTERS

1946 North 13th Street
Toledo, Ohio 43624

APPENDIX 2

Toledo Business and Technology Center Tenants

	Tenant	Employment
(M)	All Phase Mechanical Installation, repair, fabrication and removal of machinery.	2
(M)	APEX Microfilm Service Transcription of documents to microfiche for long term storage.	7
	Dawson Baker Apartment/Condo locator.	1
(M)	Brown Bindery & Packaging Book binding and packaging.	7
(M)	CareerWorks, Inc. Drafting classes.	1
	Central Medical Consultants Billing service for physicians.	7
(M)	CompCoWare, Inc. Computer based education courseware developer.	3
	Crestline Machinery Machinery brokers.	2
	Farmers Insurance Group General agent for fire, life and auto insurance.	8
	Guardian Industries Glass manufacturing.	4
	Hussmann Refrigeration Manufacturer's rep for refrigeration equipment.	1
	Investors Capital Planning Financial service	2
(M)	Newman Graphics Typesetting, printing consultant.	1

(M)	Phoenix Mutual Life Insurance General agent.	1
	SPN Associates Consultant.	1
(M)	Seagate Chemical Distributor of industrial chemicals and lubricants.	1
	Stautzenberger College	11
	Surety Life Insurance General agent.	2
	Systems Alternatives, Inc. Developer of turnkey computer systems for specialized industries.	12
(M)	Taylor Floor Covering Contract sales and installation of floor covering.	1
(M)	Telmart In-home buying service of consumer goods.	4
(M)	United Management Services Food vending, catering and janitorial contract services.	3
	Video Graphics, Inc. Video and print services.	3
(M)	WCSS Business Enterprises Construction supply.	2

(M) - Minority Owned

APPENDIX 3

[illegible]

	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
	[illegible]					Eligibility
1	[illegible]	•	•	•	•	[illegible]
2	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	
3	Urban	•	•	•	•	
4	Rural	1/3 minimum	1/3 minimum		Eligible	
5	Total	[illegible]	[illegible]	[illegible]	Unlimited in number	
6	Designation by	HUD	HUD	HUD	Commerce	
7	Oversight by	HUD & Treas	HUD & Treas	HUD & Treas	Commerce	
8	Effective date	[illegible]	[illegible]	[illegible]	[illegible]	Variable
9	Duration	[illegible]	[illegible]	[illegible]	[illegible]	Variable
	[illegible]					
10	[illegible]	[illegible]	[illegible]	[illegible]		
11	[illegible]	[illegible]	[illegible]			
12	[illegible]	[illegible]	[illegible]			
13	[illegible]	[illegible]	[illegible]			
14	[illegible]			•	[illegible]	
15	[illegible]			[illegible]		
16	[illegible]			•		
17	[illegible]			•		
18	[illegible]		[illegible]	[illegible]		
19	[illegible]			[illegible]		
20	[illegible]	[illegible]	[illegible]	[illegible]		
21	[illegible]	[illegible]	[illegible]			
22	Carry forward	[illegible]	[illegible]			
23	[illegible]	[illegible]	[illegible]			
24	[illegible]			[illegible]		
25	[illegible]	•	•			
26	[illegible]			•		
	[illegible]					
27	[illegible]	[illegible]	[illegible]			
28	[illegible]	•	•			
	[illegible]					
29	Designation priority	•	•			
	[illegible]					
30	Energy conservation credits			•		
31	Residential energy conservation credits			•		
	[illegible]				[illegible]	
32	[illegible]				[illegible]	
33	[illegible]				[illegible]	
34	Authorization				[illegible]	
35	[illegible]				[illegible]	
	[illegible]					
36	Federal Supplemental Compensation reform & extension					•
37	Job vouchers					•
38	Youth minimum wage differential					•
39	State unemployment benefits retraining assistance					•
40	State unemployment benefits relocation assistance					•

[illegible]

[illegible]

The **Chairman**. Thank you very much.

Mr. Bumpus.

Mr. **Bumpus**. Thank you very much for letting me appear today. I also thank you for putting my testimony in the record.

I probably could spend 2 or 3 days embellishing and elaborating on all the benefits of the enterprise zone as they exist today in Toledo, as you have had the opportunity to see, Senator Dole.

I will say, to keep my remarks very short, there probably are a couple of items which should be looked at very closely and that is especially and principally the benefits that would accrue to businesses which employ perhaps 100 or less. I think some item of that nature should be addressed in the current legislation.

I would only like to say and perhaps also make a personal comment: I find it significantly encouraging, Chairman Dole, Senator Chafee, that this issue is being revisited and perhaps will pass, thereby showing your party's commitment to things you have long stood for.

I thank you.

[The statement of Mr. Bumpus follows:]

STATEMENT OF REUBEN BUMPUS, PRESIDENT OF THE R. F. BUMPUS COMPANY OF TOLEDO, OHIO, ON ENTERPRISE ZONES AND RELATED LEGISLATION, BEFORE THE SUBCOMMITTEE ON SAVINGS, PENSIONS AND INVESTMENT POLICY OF THE SENATE COMMITTEE ON FINANCE, WASHINGTON, D.C., APRIL 22, 1983

****

Senator Chafee and Members of this Committee:

I am Reuben (R. F.) Bumpus, president of the R. F. Bumpus Company of Toledo, Ohio, a minority-owned and managed construction company.

I appear before you today for several reasons:

First, as evidence that minority-owned and managed companies can not only succeed but also remain committed to helping others succeed;

Second, to tell you what Toledo's experience has been in the involvement of the neighborhood in our Warren-Sherman enterprise zone area;

Third, to try to convince you of the critical importance of the enactment of enterprise zone legislation to those persons who live and want to work in these zones; and

Fourth, to offer some thoughts on what is needed in this legislation to foster successful businesses in the zones.

I will proceed in that order.

The R. F. Bumpus Company was founded eighteen years ago. It has been engaged since then in general contracting and construction mangement, and more recently in our Warren-Sherman revitalization. In this latter respect, we are serving now as the construction manager for the Bancroft-Franklin Shopping Center. Previously, we undertook the rehabilitation of a gutted, six-unit apartment building into a solar demonstration complex, as well as the rehabilitation of another six-unit, fire-gutted apartment building in the zone for our housing authority. We also did the work on the annex building for City Venture Corporation, which houses their Fair Break Center in Warren-Sherman. In these projects, we have hired people who live in Warren-Sherman, and we have trained them and thereby upgraded their skills. In our construction work in the zone and in our hiring of unskilled or underskilled persons there, we have seen first-hand the need for the enactment of this legislation.

Neighborhood Involvement

As Mayor DeGood and TEPC chairman Haigh have indicated, a major factor in the success of our Warren-Sherman area is the way its residents have participation in this project. That participation has been extensive.

One of the primary concerns in planning this project was to ensure that the benefits accrued to the residents. It was important to create a situation in which those residents would be able to obtain new jobs and to afford improved or new housing in their neighborhood. It was also crucial that the inevitable increase in the value of uses of the properties not drive them out and that they knew that this would not be allowed to occur. Consequently, neighborhood residents, under the leadership of a strong neighborhood organization, the Warren-Sherman Community

Council, have been involved extensively in this project since its beginning. They have participated in establishing project goals, planning project elements, and taking part in implementing their components. Early and continuing participation by these residents has not only ensured their acceptance and support but has also improved project concept through the utilization of their suggestions and desires.

Particular focus must be given to the success of neighborhood involvement. It is one thing to have government officials, city planners from within the private sector, non-profit developers and others tell Congress of the importance of neighborhood involvement. It is quite another thing, and I believe a convincing one, to have the neighborhood tell you of its importance. In testifying at the Joint Economic Committee's Subcommittee on Trade, Productivity and Economic Growth at its November 23, 1981 field hearing in Toledo, Inez Nash, the president of the Warren-Sherman Community Council, made some points worthy of your Committee's consideration. I quote:

> "The Warren-Sherman Community Council has been the backbone of the Warren-Sherman neighborhood since the early 1950's.
>
> "During the 1960's urban renewal era, we began to experience a rapid out migration of residents. In part, this was due to the national shift from urban to suburban living. It was also due to the emphasis of the urban renewal program.
>
> "In the early 1970's, the community development era was upon us. We found ourselves left with a neighborhood which had physically deterioriated. Our neighborhood organization

remained strong, but left behind were residents who were unskilled, unemployed and poorly educated. We were told that community development dollars would be allocated both by the city and through the community development participation process. There we were: competing with other neighborhoods whose needs were not as great as ours, yet educationally experienced enough to effectively maneuver the 'citizen participation process.'

"During 1979 at the request of George Haigh, the president of Toledo Trust, City Venture Corporation was invited into Toledo to meet with members of the Warren-Sherman Community Council. We met in the home of the late Rev. Robert Moody, a resident. ***** We were impressed because City Venture talked about jobs. In 1979 at least 33% of our residents were unemployed and over 50% were on public assistance. ***** City Venture Corporation talked about education. In 1979, 40% of all residents had not even achieved a high school diploma. ***** City Venture talked to us about housing. ***** In 1979, 75% of all properties in our neighborhood needed major repairs. ***** City Venture discussed ways in which to work with our existing day care and health care committees in order to maximize the delivery of those services.

"The Warren-Sherman Community Council has been totally involved in the process ever since that first meeting in the home of the late Rev. Moody in 1979. Our committees [executive, economic, housing, education and health] worked directly with City Venture, representatives of the City of Toledo and Toledo industries to put together the Warren-Sherman revitalization plan. The importance of this involvement was that we were directly involved with assessing needs and defining activites and programs for our neighborhood.

"The Warren-Sherman Community Council is the COMMUNITY PARTNER. We define the needs."

Mr. Chairman, those quotes are from a Black woman, a committed civic activist who not only lives in this neighborhood but also makes its interests her strongest commitment. (See Appendix 1 also.)

The Importance of Enterprise Zones to Minorities

Mr. Chairman, there are residents of Warren-Sherman today who have jobs, income and a higher standard of living for themselves and their families because Toledo has an enterprise zone. These people have something else too: better feelings about themselves and what their work is contributing to their community. We have hundreds already in the area's workforce, many, if not most, of whom would be on some form of public dependency if it were not for the jobs this zone has created. That is one side of the coin, one which looks to the present, and it is an important one.

There is another side of that coin, however, and it is even more important. It looks to the future. It looks to whether those many hundreds of others in the zone who still are unemployed or underemployed are going to have jobs created in this zone for which they can apply, be trained and employed. This Committee and this Congress are now focusing on this prospect.

When Senator Dole was in Toledo on February 19, TEPC chairman Haigh made a point to him in this regard, and I think it is worth repeating today. As this Committee knows all too well, one of the principal conceptual problems with the enterprise zone concept as offered by the Administration is the limited number of zones allowed to be designated. It is a maximum of twenty-five zones in each of three years. The number to be designated will probably be less than that maximum. Yet, if all seventy-five are designated, it is still so few in terms of the total national need for urban revitalization and jobs creation that some people have said, in essence, "Why even bother with this legislation?"

The point which Mr. Haigh made in Toledo to Senator Dole was this: This legislation may be talking about only 75 or less zones for the entire country, and such a limited number may seem like "only map tacks on the wall." But to the unemployed, the severely disadvantaged, who live and work in or around these zones, this legislation and the hope it offers to them is their entire universe. It is their entire room. This is not a point which can be taken lightly.

There is no greater evidence of this than the impact within the community in response to the fact that Senator Dole and members of the staff of his Committee, including its now new chief counsel and the counsel responsible for this subject area, had been to Toledo, had met with respect to Toledo's zone, etc. It was taken as a very positive sign that this legislation was moving forward, that reservations in 1981 and 1982 about its appropriateness were being answered constructively.

If I can make a personal comment in this respect, I find it substantially encouraging that Chairman Dole, Chairman Chafee and others on this Comittee are attempting to revive the historical commitment of their political party to this part of our population, to the Black people of our country.

Some Thoughts on Target Tax Incentives

Let me conclude, Mr. Chairman, by offering some comments about the tax incentives proposed in the Administration's bill and other measures made the subject of today's hearing. I can speak only from the experiences of myself and Toledo, but I think these experiences are instructive.

The Administration's bill provides tax credits for new investment and increased employment in enterprise zones. These credits are designed to increase the after-tax rate of return. There is a major problem with this: These provisions can apply only to those firms that have taxable profits against which credits can be taken. Realistically, that is going to be a handful of new businesses.

Most new small firms, which ought to be potent job generators in distressed areas, simply do not earn taxable income for at least 5 to 7 years. Tax credits will not help these firms. Their problem is capital, specifically, the pressing need for venture capital. This is capital to use not only to invest in new equipment and workforce, but also in research and the testing of new products, and the investigation of new markets.

Senator Boschwitz's bill, S. 98, addresses this issue, usually called "the expensing issue." It does so in its Subtitle E, Deduction for Enterprise Stock. Senator Hart's bill, S. 634, addresses this issue too. It does so in Section 233, Expense Deduction for Revitalization Area Business Stock and

Debentures. While these provisions are not the same, they are similar and addressed to the same problem.

Expensing addresses the start-up capital problem by offering a tax incentive not just to the enterprise zone firm, which may not have taxable profit, but also to the enterprise zone investor. This investor, likely to be a high-income individual in the 50% tax bracket, can deduct the cost of enterprise zone stock. This balances the higher risk involved in enterprise zone venture against a potentially far-greater after-tax rate of return for the investor. This risk is also borne by the taxpayers best able to afford it.

The expensing device of S. 98 is carefully targeted. Eligible enterprise zone stock could be issued only by qualified enterprise zone corporations, as defined in the proposed Act. These are corporations which (1) are "actively engaged in the conduct of a trade or business within an enterprise zone," (2) "with respect to which at least 80% (of the corporation's) gross receipts for the taxable years are attributable to the active conduct of a trade or business within an enterprise zone," and (3) "with substantially all of their tangible assets located within an enterprise zone." Additional protections have been added to prevent abuse of the funds.

Appendix 2 sets forth this proposal in depth.

I hope this Committee includes Subtitle E of S. 98 in the text of the bill to be reported to the full Senate.

APPENDIX 1

THE TOLEDO BLADE, April 12, 1983, p. 12

William Brower

New Horizon For Toledo's Biracial Effort

THE fact that whites and blacks broke bread together earlier this month at the annual membership luncheon of the Toledo branch of the National Association for the Advancement of Colored People is not news. The branch has white members and has traditionally enjoyed their presence at the luncheon and at the Freedom Fund dinner, both annual fund-raising events.

What has prompted special comment here about the occasion is that a new dimension in racial cooperation seems to be on the horizon in Toledo. If this reading is accurate, there is genuine hope that the poisonous atmosphere between blacks and whites that is wracking Chicago today can be averted in our city.

Not merely incidental at the luncheon, the principal speaker was one of the city's leading corporation executives — George W. Haigh, president of Toledo Trust. This was the first time in the memory of anyone attending the affair that a white civic, business, political, or religious figure — or a white person, period — has been invited to appear in this role.

* * *

Several other corporation officials attended. It is assumed that they did not come along as a cheering squad or otherwise to lend moral support to Mr. Haigh. Rather, I'm sure, the NAACP leadership hopes that they are sincerely interested in developing a dialogue on common problems with the black community.

In fact, this seemed to be the tack taken by Mr. Haigh in his remarks. In this instance he was offering more than empty promises. Solid accomplishments already are evident.

With some pride Mr. Haigh discussed the progress of the revitalization of the Warren-Sherman area. The near-downtown location was a symbol of seemingly irreversible poverty less than two decades ago. Now it is being praised nationally and internationally as a model approach to solving problems of despair, decay, and unemployment.

President Reagan has talked glowingly of designating enterprise zones, especially in black communities, to promote capitalism. Ohio has already selected Warren-Sherman under state legislation creating such zones. If Congress passes legislation establishing federal enterprise zones, Warren-Sherman may also get Uncle Sam's blessing.

* * *

Money talks. Of the $55 million Mr. Haigh said was projected for the redevelopment of the depressed area, $32 million, including $20 million from private sources, has been committed.

This investment means that since 1979 a total of 600 persons, nine of 10 of them public-aid recipients, have been employed. Eight of 10 are black; more than half of the jobs are in their neighborhood, with the remainder scattered throughout Toledo.

Mr. Haigh lauded the contributions of the Business and Technology Center, a subsidiary of Control Data Corp.; the 23-acre industrial park containing an Owens-Illinois box plant employing a force of 20, and a property management and maintenance company with 17 on the payroll.

The latter is operated by the Warren-Sherman Community Council, which has been the private arm spearheading the redevelopment undertaking.

A shopping center soon will open, with most of the businesses available for minority ownership. A program also is on the drawing board for the construction of additional new housing and the rehabilitation of existing dwellings.

Perhaps in the long run an even more exciting venture is the Scott High School remedial skills program. The computer-based educational training is attracting both young persons and adults. The school's skill center prepares them to qualify for specific jobs in a computerized bank administered by the community council.

* * *

Mr. Haigh explained that he used Warren-Sherman as an example "because it clearly demonstrates the impact of what can be accomplished in a neighborhood that previously had little hope."

"When diverse groups come together," he said, "with a common goal of creating jobs for those who live there dramatic changes can take place."

Mr. Haigh himself, in my judgment, made a dramatic departure from his milieu when he declared that no one wants a handout or to live on welfare — "but they can only get away from that if there is a proper environment — if there is an opportunity to qualify for a job. It is the role and responsibility of the private sector to create that environment and opportunity . . . "

He also demonstrated corporate statesmanship when he invited the Toledo NAACP to join the process:

"The NAACP is an organization which has been in existence for many years and is highly respected. And it seems with the expertise and commitment this organization has to seeing that minorities get their fair share they can work with the neighborhoods, with the city, and with the private sector to see that job training and job creation go hand in hand and that our city in its entirety benefits in the long run."

APPENDIX 2

SEED CAPITAL IN ENTERPRISE ZONES:

The Equity Expensing Proposal

1. What is "equity expensing" and what purpose does it serve?

The Enterprise Zone Tax Act currently provides tax credits for new investment and increased employment in enterprise zones. These incentives will substantially increase the after-tax rate of return--for those firms that have taxable profits against which credits can be taken.

Most new small firms, the most potent job generators in distressed areas, don't earn taxable income for five to seven years. During that time the firm's most pressing need is venture capital: capital used not only to invest in equipment and hire workers, but also to research and test new products, investigate markets, and provide cash during the initial period when the firm is not yet operating in the black. In other words, they need "seed corn" to get the business started.

Expensing addresses this start-up capital problem by offering a tax incentive not just to the enterprise zone firm, which may not have taxable profit, but also to the enterprise zone investor. This investor, likely to be a high-income individual in the 50% tax bracket, can deduct the cost of enterprise zone stock. This balances the higher risk involved in enterprise zone venture against a potentially far-greater after-tax rate of return for the investor. This risk is also borne by the taxpayers best able to afford it.

Expensing is carefully targeted. Eligible enterprise zone stock could be issued only by qualified enterprise zone corporations, as defined in the Enterprise Zone Tax Act. These are corporations which 1) are "actively engaged in the conduct of a trade or business within an enterprise zone," 2) "with respect to which at least 80% (of the corporation's) gross receipts for the taxable year are attributable to the active conduct of a trade or business within an enterprise zone," and 3) with substantially all of their tangible assets located within an enterprise zone." Several additional protections are added to prevent abuse of the funds; these will be discussed below.

A more important point is that expensing, like the entire enterprise zone concept, is based on the assumption that the Federal government is better equipped to help new and small firms with general incentives and an environment for growth than with direct assistance. Dr. David Birch of M.I.T., in his path-breaking empirical analysis of job creation, drew just this conclusion:

> "The job-generating firm tends to be small. It tends to be dynamic (or unstable, depending on your viewpoint)-- the kind of firms that banks feel very uncomfortable about. It tends to be young. In short, the firms that can and do generate the most jobs are the ones most difficult to reach

> through conventional policy initiatives. . .The very spirit that gives them their vitality and job-creating powers is the same spirit that makes them unpromising partners for the development administrator.
>
> What the data suggest is that those cities that wish to capitalize on the job-generating powers of the smaller businesses within their boundaries are going to have to complement the traditional economic development vehicles with a broader approach. They must come to understand the special needs of the entrepreneur. They must work with their state legislatures to develop indirect tax and regulatory strategies that foster the percolation of thousands of small businesses while they work on the politically more satisfying task of handing out money directly."

Equity expensing is not a substitute for other government capital assistance. But we need to keep the role of government capital in perspective. UDAG and SBA loans together will provide a little over $1 billion in new capital this year, and most of this will not be venture capital. At the same time Americans have invested over $200 billion in money market funds in their search for a real after-tax rate of return. If we could capture even one percent of this private capital for our inner cities we would dramatically increase their capital base.

2. How would it work?

In simple terms, any individual who purchased enterprise stock would be entitled to a Federal tax deduction equalling the amount of the investment. For example, a person who put $10,000 into a qualified zone company would be able to claim a $10,000 deduction on his or her Federal tax return for that year. If the taxpayer were in the 50% bracket, the deduction would reduce taxes owed for that year by 50% of the $10,000 or $5,000. This investment must be held for at least 3 years (or the tax break is recaptured *with* interest). After the three year period is up the investor pays no capital gains on sale of the stock; however, he or she must then pay income tax on the original investment ($10,000 in the example given above.)

An investor in the 50% tax bracket who buys $10,000 in enterprise stock, and sells it five years later for $30,000, reaps a 38% real after-tax rate of return. A $10,000 investment sold after five years at $15,000 reaps a 15% after-tax rate of return. This should make enterprise stock highly competitive in the capital markets.

3. Won't this proposal encourage people to make investments with no real economic value just to get a tax break?

No. Again, the proposed tax incentive would only give the taxpayer *up to* one half of the money invested back in the form of Federal tax savings. Most of the return of and on the investors' capital would have to come from dividends or from the subsequent sale of the investment. In other words, the investment would only pay off if the firm succeeds.

4. Isn't this going to be taken advantage of by the bigger businesses which really do not need the incentive?

No. To be qualified for the deduction, an issuer of enterprise stock must be a business of less than $2 million net worth.

5. Isn't there a danger that the proceeds from the sale of enterprise stock will be taken by the company and used outside the zone for purposes not contemplated in the act?

No. The businesses must be actively engaged in the conduct of a trade or business within the enterprise zone. Further, it must have at least 80% of its gross receipts attributable to such enterprise zone business. Lastly, it must have substantially all of its assets located within the zone.

6. But can't the business get around this by deriving its income from passive sources, such as interest payments or dividends? What are the safeguards?

There are two safeguards. First, the qualified issuer may not have derived more than 50% of its gross receipts from certain types of passive income -- e.g., royalties, certain rents, dividends, interest, annuities and sales and exchanges of stocks or securities. Second, if the issuer fails such a test in any of the four years following the stock issue, a recapture occurs. The threat of this recapture will "keep the pressure on" the business to meet the tests.

7. Isn't there a very large loophole here, one which permits an unincorporated sole proprietorship or partnership to incorporate and issue enterprise stock just for the purpose of taking advantage of the deduction?

No. Subtitle G contains a provision denying the deduction with respect to the incorporation and/or transfer in a non-taxable transaction of an existing business to a corporation that would meet the definition of a qualified issuer.

8. What about people who purchase enterprise stock from the original investor? Would they also be entitled to the deduction?

No. Only the original purchaser of enterprise stock or debentures will be entitled to the deduction. Once the investment is sold to a second owner, it would lose its special tax status.

9. Given the high failure rate of new and small firms, won't this proposal simply make it easy for people to lose money?

Some investors will undoubtedly lose money. However, the incentive is aimed principally at people in high tax brackets who can afford the risk. In addition, our proposal would permit the formation of professionally managed investment partnerships to assess and make risky investments on behalf of individual investors. For example, MESBICs and SBICs might form subsidiaries to develop and manage such investment pools.

The CHAIRMAN. I think there is, as we have noted earlier, strong bipartisan support for this, and I am certain that Senator Long has indicated his interest. Louisiana and Kansas happen to be a couple of States that have State enterprise zone legislation, which would be a great supplement if we can do it.

I would only say that we have our constraints on revenues. That might be one thing that we won't be able to accommodate everything that has been suggested here this morning.

I would, if the rest of you have time, I would like to hear Mayor John Smith on behalf of the National Conference of Black Mayors now and then perhaps there might be questions.

Mayor.

STATEMENT OF HON. JOHN SMITH, MAYOR, PRITCHARD, ALA., ON BEHALF OF THE NATIONAL CONFERENCE OF BLACK MAYORS, INC., ATLANTA, GA.

Mr. SMITH. Mr. Chairman, I am here this morning representing the National Conference of Black Mayors and to give general support for action by the Senate to establish the Enterprise Zone Employment and Development Tax Act for 1983, and to recommend some specific amendments to the legislation in order to account for some of the specialized problems and needs that we feel that our cities have.

I also chair the Resolutions Committee for the National Conference of Black Mayors, and in that capacity I advise our conference on policy issues that may have significant impact on our cities. I also have the distinction of having established my own local enterprise zone without support from the Federal Government or our State. We don't have legislation in our State.

So I am speaking here as an individual who has also tried to operate a program but without all of the necessary ingredients in place. I am told that when we took office, that EDA had classified our city as the third most distressed of its size in the United States. So I think we have a story here to tell.

The CHAIRMAN. What is the population of your city?

Mr. SMITH. 39,000.

The National Conference of Black Mayors is a technical services organization representing 225 mayors and cities in the United States. Many of the cities in our conference are of less than 50,000, and we are pleased that some of these bills include a minimum designation in rural areas.

The National Conference of Black Mayors has supported the concept of enterprise zones since its initial discussions by Congress. However, the organization reserved total support on these early discussions due to the fact that the concept did not include rural settlements and it did not have a concept to account for the demand for scientific and technical information on enterprise development and what impacts it would have on black settlements.

The National Conference of Black Mayors established by resolution the enterprise zone concept as a major feature of its program for 1982 and 1983 and addressed it in its official position paper on the subject, and the need for research and scientific and technical information on enterprise zones and ethnic-cultural development.

We feel that the legal authority to establish enterprise zones must be integrated with technical procedures for planning, design, and management of such systems if we are to achieve the national goal of establishing experimental prototypes of self-reliant employment and development programs. Enterprise zones, as suggested in the bill, are legal concepts which must evolve into technical operational reality. The absence of legal technical features in the bill is a serious limitation and should be addressed before its passage.

Employment and development problems in distressed areas of the United States are essentially problems of attracting, integrating, and maintaining economic resources within the defined area. The bill provides the legal basis for attracting development and business resources through its Federal income tax incentives and the removal of regulatory barriers.

However, the specialized process, technique, and method of planning, design, implementation, and management of enterprise zones as an employment and development tool for integrating and maintaining the economy are not directed in the bills. The course of action which outlines steps to improve the climate for job creation, economic growth, and community development are technical research, planning, design, and management propositions, which must be captured for utilization by the vast majority of cities and communities that will not be among the selected elite to participate in the national enterprise zone prototype.

Since many of the member cities and mayors of the National Conference of Black Mayors will not be selected, and since a great majority of our cities house the economically disadvantaged, the unemployed in the distressed areas of the Nation, we deem it critical that a scientific, technical component beyond the requirement that the Secretary submit periodic reports be created.

It is the position of the National Conference of Black Mayors that enterprise zones should be a commitment to the future, a future in which American black settlements will cease to be distressed zones, Federal plantations, and poverty pockets dominated by Federal interference and control.

Instead, vibrant, viable, and functioning self-reliant communities are projected to emerge around the applications of new technology, science, art, and the humanities to problems of ethnic development and employment. Science and technology have always dominated the economic foreground for successful industry, the American military, and in distinguishing between the exceptional and mediocre universities.

The National Conference of Black Mayors is suggesting that the same spirit which resulted in the evolution of NASA be applied to solving the employment and development problems of American black settlements. The conference is further suggesting that we adopt a long-range view of this problem rather than a short-range perspective, that the Enterprise Zone Employment and Development Tax Act is the messiah of modern times.

For the above conceptional and factual reasons, and in order to receive our full rather than our general support, the National Conference of Black Mayors recommends the following adjustments and/or amendments.

One, that provisions for community reinvestment credit, the Community Reinvestment Credit Act that requires banks and savings and loans to participate in the investment of our communities, that some provisions be established within the language that you are using currently.

Second, we feel that since this is an experiment, that you should allow any local government which is eligible to receive community development block grant assistance to participate in what we would term secondary enterprise zones. For instance, cities such as ours have created their own zones. We have created kind of a climate and a spirit, and while we may not become a Federal designation, we should be allowed to participate as a secondary enterprise zone.

Again, if you write provisions for the banks and savings and loans who have participated with us, I think we can use our own creativity and begin to mount some kind of economic development program for ourselves.

Third and most important, since this is a national experiment, we feel that some provision in the bill should be redrawn to allow all of the experiences and all of the stories and all the successes that are collected both during the experiment and after the experiment, that they be housed with some scientific and technical institute, that the 225 cities that we represent be allowed to gather up that information so that these stories can be learned and utilized by mayors in our cities in trying to solve these great problems that we are up against.

Then last, Mr. Chairman, I would like to make a recommendation that you hold some of these hearings in some of our cities also so that the general population can understand what these technical discussions are all about because I am not sure that the people who will benefit most really understand what is going on here. So I would suggest or recommend that you hold some of those hearings in places such as Pritchard, Ala., and I would like to offer you the opportunity to come to our city.

Thank you very much.

The **Chairman**. I am not certain if Senator Chafee has thought of that. It is an idea that I think we might want to consider, with some thought that Congress might not be in session in July, though I think that thought is slipping away, and we were going to use that time to have field hearings on a number of things. Enterprise zone would certainly be an appropriate one if we haven't passed the legislation, or even if we have passed the legislation. Again, I would hope that we might be able to do that.

I would just say that we think this testimony is very valuable because you are all in the process of doing something about it. You are not just here saying well, here is a chance to get a few little Federal goodies. You are already making it work. I know you have a lot of suggestions that we probably can't accommodate. At least some we can't because they would again impact on revenues, and we are not in the best shape either at the Federal level.

You are going to be followed now by a witness from the AFL-CIO who opposes this legislation. It might also be helpful, to comment on employment, because I think you must all believe that you are not going to displace workers, that you are going to create employment, put more people back to work, and I think that is the concern that organized labor has, that this may somehow have an adverse impact on not only their members but workers generally.

George, you mentioned labor in your statement. I assume you have had in your area cooperation with organized labor. Is that correct?

Mr. VOINOVICH. That is correct. We have had cooperation from organized labor. Originally, when it first came out, there was some reluctance to become involved, but once the information was made available on what we were trying to accomplish, and the joining together of all the forces, organized labor became a part of our local effort.

The CHAIRMAN. The same in Toledo? I assume everybody has the same experience.

Mr. DEGOOD. We went through a virtually identical experience. We brought people from organized labor into the process very early and they have been very supportive of the entire program.

The CHAIRMAN. I think it may be an area that certainly you would want to be alert to. We are going to continue, as you have requested, to move as quickly as we can. There may be an additional hearing. We are not certain whether we will need an additional hearing, but we will start working with your representatives as we put together the legislation.

Senator Long, do you have questions?

Senator LONG. No, Mr. Chairman.

The CHAIRMAN. Senator Chafee?

Senator CHAFEE. Mr. Chairman, this panel has been helpful. Some of the witnesses have appeared before us already on this matter, but others are new and we have gotten a lot out of their testimony. We will be talking with the League of Cities and Conference of Mayors and Conference of Black Mayors as we proceed along here.

Thank you.

The CHAIRMAN. Anything else that anyone wants to add?

Thank you very much. We appreciate your coming and your appearance this morning.

Our next witness is Arnold Cantor, assistant director, Economic Research Department, American Federation of Labor, AFL-CIO.

We are pleased to have you here this morning, Arnold. We would hope, as you normally do, that you might summarize your statement. We have been urging the Administration and the mayors to work out any problems and just concerns that you have about this type of legislation. I hope they do that.

STATEMENT OF ARNOLD CANTOR, ASSISTANT DIRECTOR, ECONOMIC RESEARCH DEPARTMENT, AMERICAN FEDERATION OF LABOR AND CONGRESS OF INDUSTRIAL ORGANIZATIONS, WASHINGTON, D.C., ACCOMPANIED BY STEVE KOPLAN, LEGISLATIVE REPRESENTATIVE, AND FRANK PARENTE

Mr. CANTOR. Mr. Chairman, I must admit the room is a little cold but my ears are warm.

Senator CHAFEE. You are the heavy here today.

Mr. **Cantor**. I am the heavy here today. I have good company with me. On my left is Steve Koplan, our legislative representative, and on my right is Frank Parente, who works on my staff and handles a lot of our urban problem areas.

I will be very, very brief, Mr. Chairman. I would like to take this chance to reaffirm our opposition to the enterprise zone legislation that is before you. We feel the administration's bill, as well as S. 98 and S. 634 offer an array of tax reductions and other devices which, in effect, will encourage a reduction in public revenues, programs, standards, and safeguards.

We feel they will not create additional jobs, nor help solve critical urban public and private investment problems.

We feel government—Federal, State, and local—has a key role to play in fighting unemployment and in helping to solve some of the fundamental problems that are the source of urban joblessness and decline, which really, to us, is the opposite notion of this bill.

The tax benefits that apply to enterprise zones in the administration's bill would, we are convinced have the effect of drawing footloose businesses into the zones from other areas without contributing any net increases in the number of jobs. The only certainty would be a loss of tax revenue and more destructive inter and intrastate competition to keep or to pirate industry.

The elimination of capital gains taxes would serve as an inducement to sell out and leave the zone. The employment tax benefits could lead to extremely inequitable situations and a powerful incentive for counterproductive shutdowns, relocation, and job loss.

The administration's bill also induces States and localities to roll back zoning, occupational licensure laws, usury laws, price controls, permit requirements, planning regulations, and building codes. We feel, though this is not the intent of the legislation, this could threaten the public health and safety, and ironically we feel it puts the weight of the Federal Government into preempting State and local decisions.

The AFL-CIO has proposed an economic program. Under that program, needed public services would be expanded, planned public works would be built; low- and moderate-cost housing constructed and rehabilitated, more youth trained and placed in jobs, and displaced workers assisted. Extended unemployment insurance would provide longer support for the joblessness; there would be mortgage and rent payment relief, as well as health care established for the unemployed.

We have appended that program to our statement, Senator Chafee, and we would appreciate if it is included in the record.

We also advocate a reindustrialization program that involves Government, business, and labor, as has been talked about so much today.

We feel a national industry policy should be supported by a new Reconstruction Finance Corporation set up to rebuild the Nation's industrial base with loans, grants, guarantees, and if necessary, targeted tax policies to strengthen investment in basic industries and new high growth industries.

We would also like to see special consideration given to areas of high unemployment.

We feel America must deal with the immediate needs of its 11 million jobless, and well as the specific problems of particular groups of workers and distressed areas and regions. These goals, in our view, require input and cooperation from all sectors of the economy.

They will not be served through proposals like enterprise zones, which merely continue what is in our view a myth that Government is the source of our ills, and cutting taxes, lowering standards and reducing services are the cures.

We therefore urge rejection of the enterprise legislation before you and ask your consideration of the AFL-CIO jobs and fairness program. Thank you.

[The statement of Mr. Cantor follows:]

Statement of Arnold Cantor, Assistant Director,
Department of Economic Research,
The American Federation of Labor and Congress of Industrial Organizations
Before the Committee on Finance
on
Enterprise Zone Legislation

April 22, 1983

The AFL-CIO is pleased to have this opportunity to reaffirms its opposition to Enterprise Zone legislation. The Administrations new bill, S.863, as well as S.98, and S.634, offer an array of tax reductions and other devices which directly and indirectly encourage a reduction in public revenues, and cuts in programs, standards and safeguards. They will not create additional jobs nor help solve critical urban public and private investment problems.

This has been our consistent view since enterprise zone legislation was first introduced for congressional consideration. The 1983 version of enterprise zones, embodied in the legislation before this Committee is fundamentally the same as past proposals. The AFL-CIO Executive Council's characterization of the concept as "little more than a localized version of 'trickle down' economics" is valid in its application to the present rendition of the idea. As the Council has noted, the concept is based exclusively on the notion that "...local economic problems will disappear if government would spend less, tax less and protect less." We take an opposite point of view. We feel government — federal, state and local — has a key role to play in fighting unemployment and in helping to solve some of the fundamental problems that are the source of urban joblessness and decline.

The tax benefits that apply to enterprise zones in the Administration's bill, (S.863) would have the effect of drawing footloose businesses into the zones from other areas without contributing any net increase in the number of jobs. The only certainty would be a loss of tax revenues and more destructive inter and intra state competition to keep or to pirate industry through tax relief schemes.

The elimination of capital gains taxes in the enterprise zones would serve as an inducement to sell out and leave the zone, since there would be no tax liability on the profit of selling a business.

The employment tax benefits for employers are limited to firms within the designated zone. However, in many urban areas existing and potential employment is outside the zone. Thus, a firm outside the zone, employing many zone residents would get no benefit. This, of course, could lead to extremely inequitable situations and a powerful incentive for counterproductive shutdowns, relocations and job loss.

It is also likely that many stable, existing firms in the zone that are and have been providing employment may not be able to meet the bill's qualifying criteria for financial or other reasons and would be unable to compete with a new firm that is heavily subsidized through the tax benefits.

A resident of the zone, working within the zone could receive a 5% wage credit. Yet, his or her neighbor whose job might be outside the zone would get no such benefit. Again an extremely inequitable result.

Ever since the first experiment with jobs tax credits in 1971, study after study has shown this device to be flawed. A recent study for example, published in the New England Economic Review(September/October 1982) notes that such devices "... enhance the employment of some groups only at the expense of others..." and expanding the role of such subsidies "... would encourage such displacement at a time when unemployment is at its highest rate since the Great Depression."

The legislation could also weaken health and safety protections and weaken governmental regulations. The designation of enterprise zone areas as foreign trade zones not subject to tariffs and import duties, for example, would undermine these government international trade rules.

The legislation also would pressure states and localities to cut taxes in order to enhance their chances for designation as an enterprise zone. It seems to us that "winning" in that competition would mean that the "successful" enterprise zone applicants' ability to provide necessary services to its citizens would be further diminished. It would also assure that those jurisdictions which are most financially able will rank high as zone applicants.

The Administration's bill also induces states and localities to rollback zoning, occupational licensure laws, usury laws, price controls, permit requirements, control planning regulations and building codes. This, we feel, could threaten the public health and safety which is the basic purpose of such laws and regulations. Ironically, this also puts the weight of the Federal government into preempting state and local decisions determined on the basis of local conditions.

S.98 and S.634 are also replete with tax "incentives" which we oppose. S.98, contains an "equity expensing" tax shelter, for example, which is supposed to generate startup capital. Under that provision investors could write off $100,000 per year in order to buy stock in an enterprise zone business, deferring taxes until the stock was sold. There would be no tax on any capital gain when the stock was sold. The amount initially written off would then be included in ordinary income. This would indeed be a generous -- and costly -- inducement to invest. It would, in fact, be a major benefit to the wealthy financed in the main by all other taxpayers. S.634 is open ended in allowing the approval of an unlimited number of revitalization areas with the designation of successful applicants for 20 years each. This commits an unknown but potentially very large drain of public funds into doubtful endeavors for a long period of time. We also have serious reservations over the emphasis in S.634 on "Employee" and "General" stock ownership devices. The former envision's employee ownership of business in distressed areas, the latter would have local residents form investment corporations to influence development.

Enterprise Zones are not the route to urban development and job creation. They will either be a poor substitute for or a diversion from effective action which is needed for immediate job creation and to deal with the specific reindustrialization and revitalization needs of distressed areas.

The Administration, for example, has claimed this legislation "...will provide for the creation of meaningful jobs in the private sector and long term revitalization of our nation's most depressed areas." At the same time the Administration continues the policy of annually offering fewer resources to meet national and city problems through categorical programs.

In the 1984 budget, the Administration proposed $19.4 billion in cuts for non-defense programs. The cuts from such programs as job training, education, housing, Medicare, Medicaid, food stamps and child nutrition are proposed in the face of the attendant hardships or a severe recession. Among other things, the Administration proposed to phase out subsidized housing production and to include housing under the community development block grant program diluting funds in both programs. This means fewer net resources for community development. The Economic Development Administration and other programs serving community development purposes and creating jobs are also cut back.

Similarly the Administration's proposed Employment Act of 1983 looks to Enterprise Zones as a job creation program along with a potpourri of other devices that essentially rely on rearranging and reshuffling joblessness. These include only $240 million for for training displaced workers, a subminimum wage for youth and a wage subsidy device whereby employers would be encouraged to lay off current and hire workers holding vouchers. These vouchers in turn would be credited against the employers unemployment insurance and income tax liabilities.

Despite the evidence that the recession is behind us, the latest official forecasts still project that unemployment will be at or above 8 percent for 3 years, and the Congressional Budget Office is even more pessimistic. Thus, though the Administration has pronounced its recession over with, and the economics community is wrestling with "turning points," the recession is still very real for the 11.4 million Americans who were jobless during the first 3 months of this year, the 1.8 million indiviudals who were so discouraged they had given up looking for work, and the 6.5 million people who were involuntarily working part time.

The state and local unemployment figures for February, the lastest month available, document the fact that conditions are literally at depression levels in many areas. For example, unemployment rates in West Virginia, Michigan and Alabama, the worst states, are 21.0, 16.5 and 16.1 percent respectively. Thirty-five metropolitan areas have unemployment greater than 15 percent, the highest being Johnstown, Pennsylvania with 25.9 per cent.

The AFL-CIO has proposed an economic program to provide jobs for the unemployed and increased fairness in the tax and budget policies of the federal government. Our program, would provide 900,000 jobs in 1983, 1.8 million jobs in 1984, a stimulus that would put this country on the road to full employment.

Needed public services would be expanded, planned public works would be built, low- and moderate-cost housing constructed and rehabilitated, more youth trained and placed in jobs, and displaced workers assisted. Extended unemployment insurance would provide longer support for the jobless. There would be mortgage and rent payment relief as well as health care established for the unemployed.

To finance these programs, we have proposed a number of tax changes and reforms including a cap on the 1983 individual income tax cut and the repeal of indexation.

In addition to tax and budget policies, the federal government also must pursue a more expansionary monetary policy as well as a trade policy that attempts to achieve fair trade and reorganizes this nation's needs and problems.

We also advocate a reindustrialization program that involves government business and labor. A national industrial policy supported by a new Reconstruction Finance Corporation should be set up to rebuild the nation's industrial base with loans, grants, guarantees, and targeted tax policies to strengthen investment in basic industries and new, high-growth industries. Special consideration should be given to areas of high unemployment.

In place of across-the-board tax cuts and accelerated depreciation and instead of the proliferation of wasteful tax loopholes, we need a new targeted investment program as part of an overall reindustrialization policy. To that end, the AFL-CIO has proposed the creation of a tripartite National Reindustrialization Board -- including representatives of labor, business, and the government -- which would determine the amount and type of any tax incentive or accelerated depreciation allowance granted to any company on a case-by-case basis with some type of certificate of necessity. Investment credits would be clearly targeted to industrial sectors and regions where they are needed.

This Board would also direct the activities of a financing agency, patterned after the Reconstruction Finance Corporation of the thirties and forties which would be authorized to make and guarantee loans to finance approved reindustrialization ventures. Private pension funds should be permitted and encouraged to make investments in such financing arrangements to support and expand industrial employment in the United States.

An RFC would have authority to allocate tax expenditures and additional funds in loans, loan guarantees, and interest subsidies which, in turn, could leverage private capital. The emphasis would be on basic industries, and allocation decisions would include factors such as eliminating capacity "bottlenecks," helping new U.S. industries with a high growth potential, and aiding firms that have difficulty competing because of unfair foreign practices.

Eligibility considerations include reasonable demonstrations that the aid would be used to finance net increases in domestic investment and would be compatible with the local area's development plans and needs. All recipients would have to comply with nondiscrimination provisions of federal civil rights and labor laws.

Under the AFL-CIO concept, reindustrialization would involve capital formation for moderinzation of existing plant and equipment or it could be the creation of new industrial complexes, utililties and services at a cost which would make them marketable, thereby preserving and expanding employment. Another implication is that there would be government intervention to help provide the funding for a necessary investment in targeted industrial sectors, and favoring locations to reduce duplication of facilities insofar as possible.

Public infrastructure which is suffering from deferred maintenance must be improved, including replacement and expansion of large components in water, sewer, highway and mass transit systems, to enhance efficiency of economic functions and livability in major urban areas. Such improvements could also maximize utilization of existing urban plants and minimize costly replication of facilities elsewhere, and help in dealing with large concentrations of unemployed youth.

America must deal with the immediate needs of its 11 million jobless as well as the specific problems of particular groups of workers and distressed areas and regions. These goals in our view require input and cooperation from all sectors of the economy. They will not be served through proposals like Enterprise Zones which merely continue the myth that government is the source of our ills and cutting taxes, lowering standards and reducing services are the cures.

We, therefore, urge you to reject the Enterprise Zone legislation and ask your consideration of the AFL-CIO jobs and fairness program which we have added to our testimony.

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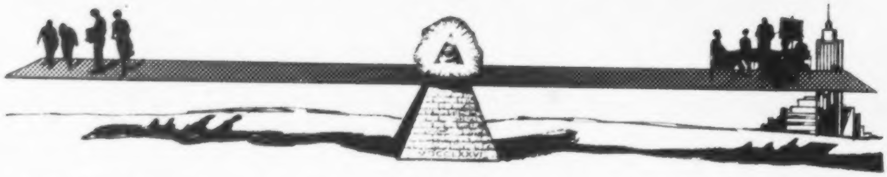
AFL-CIO ECONOMIC PROGRAM FOR JOBS AND FAIRNESS



This issue of the Federationist contains the AFL-CIO Economic Program for Jobs and Fairness, along with background papers, adopted by the AFL-CIO Executive Council at its meeting in Bal Harbour, Fla., Feb. 21-28, 1983.

The AFL-CIO proposes an economic program to provide jobs for the unemployed and increased fairness in the tax and budget policies of the federal government. Our program would provide 900,000 jobs in 1983, 1.8 million jobs in 1984, a stimulus that would put us on the road to full employment.

Needed public services would be expanded, planned public works would be built, low- and moderate-cost housing constructed and rehabilitated, more youth trained and placed in jobs, and displaced workers assisted. Extended unemployment insurance would provide longer support for the jobless. There would be mortgage and rent payment relief as well as health care established for the unemployed.

The AFL-CIO program calls upon the Congress to reject some $19.4 billion in Administration proposed budget cuts for non-defense programs. The proposed cuts from such programs as job training, education, housing, Medicare, Medicaid, food stamps, and child nutrition should not be made in the face of the severe recession and its resulting hardships.

Federal employees should not be made the sacrificial offering for Reagan's budget slashing efforts. Fairness demands that federal employees receive pay commensurate with the private sector while the promise of decent retirement is kept.

Decimation of state and local government funds should be reversed to offset the many budget cuts, the transfer of federal responsibilities, and the harmful effects of loss of state revenue sharing and the freezing of local revenue sharing.

To pay for these programs, the AFL-CIO proposes that Congress close a number of tax loopholes that benefit particularly wealthy individuals and corporations. Important tax changes would include a $700 cap on the fiscal 1983 individual tax cut and the repeal of future indexing of tax rates. Needed corporate tax changes include the changing of the foreign tax credit to a deduction and the reforming of the investment tax credit.

The AFL-CIO is convinced that the nation can meet its national security needs without the 9 to 10 percent real increase in the defense budget requested by the Reagan Administration. We propose limiting the increase to real growth rates of 5 to 7 percent. (A number of members of the Executive Council have expressed the strong opinion that the increase should be held to the lower end of this range or below.) This approach would cut the defense outlays and authorizations by some $3 to $5 billion in outlays and up to $14 billion in authorizations in 1984 and would amount to $23 billion to $47 billion in outlays and up to $78 billion in authorizations for the years 1984 through 1986, according to the Congressional Budget Office. We propose that this 5 to 7 percent increase in real defense spending should be paid through a progressive surtax levied on the corporate and individual income tax plus an additional tax on income currently sheltered.

We reject the President's proposal to attain defense savings by putting a freeze on civilian and military pay and curtailment of retirement benefits. Curtailments and stretch-outs, particularly in the procurement of new weapons—the area with the biggest increases—rather than in defense readiness should be the means to attain defense savings.

The AFL-CIO program would increase the federal deficit slightly in the near term, but would reduce the federal deficit directly by some $148 to $151 billion in 1986, not counting the substantial indirect effects resulting from putting people back to work, as $30 billion is regained for the Treasury by each one percent drop in unemployment.

But in addition to tax and budget policies, the federal government also must pursue a more expansionary monetary policy as well as a trade policy that attempts to achieve fair trade.

For long-term revitalization, the government must pursue a reindustrialization program that involves business and labor. A national industrial policy supported by a new Reconstruction Finance Corporation should be set up to rebuild the nation's industrial base with loans, grants, guarantees, and targeted tax policies to strengthen investment in basic industries and new, high-growth industries. Special consideration should be given to areas of high unemployment.

The token jobs program proposed by the Reagan Administration in response to Congressional pressure is a recognititon of the serious problem of unemployment. It is, however, only a small first step. We support a quick relief package to be followed by more comprehensive jobs legislation.

Today, 11.4 million American workers are officially jobless (10.4 percent) and 1.8 million have become discouraged in their search for work and have dropped out of the labor force. Unemployment has increased by 3.6 million since July 1981. Moreover, some 1.5 million workers will be entering the labor force each year over the next five years.

Despite some recent signs of an economic upturn, there are few predictions of an early end to high unemployment. There is even a danger that continued high interest rates will curtail the recovery.

Even after five years of projected improvement, unemployment will be higher than it was in 1979, according to the Reagan Administration's own forecast or that of the Congressional Budget Office. (Table below.)

When the private sector cannot provide enough jobs, the federal government must

	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988
Adm.*	5.8	7.2	7.6	9.7	10.7	9.9	8.9	8.1	7.3	6.5
CBO*	5.8	7.2	7.6	9.7	10.6	9.8	9.0	8.4	8.0	7.5

* (1979-1982 actual as percent of civilian labor force, 1983-1988 projected by Administration as percent of total labor force, including armed forces stationed in the U.S., by Congressional Budget Office as percent of civilian labor force.)

step in. This is the mandate of the Employment Act of 1946, reaffirmed in 1978 by the Humphrey-Hawkins Full Employment and Balanced Economic Growth Act.

It is clearly in the economic and social interest of the nation to put Americans who are able and willing to work into productive jobs which generate taxes, produce useful community services and community facilities, and stimulate the economy in communities with high unemployment.

A large-scale, adequately funded anti-recession job creation program, had it been put into effect last year, would have very significantly reduced unemployment, eased the severity of the recession and also significantly cut the long-term federal budget deficit. Last year the President projected a federal budget deficit of $91 billion for fiscal 1983 and told the nation that a jobs program would be too costly. Now the Reagan Administration tells us the 1983 deficit will be $208 billion. If unemployment were cut in half, the federal deficit would be cut by more than two-thirds.

To meet the nation's pressing needs, the program the AFL-CIO is proposing would provide a large number of jobs for the unemployed, re-establish fairness in the tax system, bring some balance to defense needs and maintain essential domestic programs. We urge the AFL-CIO program as the best way to return to a healthy, vibrant economy.

AFL-CIO JOBS AND STIMULUS PROGRAM

The AFL-CIO program for job creation includes community development supplemental jobs, accelerated public works, and a recovery for the housing industry. In addition, special action is needed for dislocated, minority and young workers, and all workers in all categories who require added protections during this time of disaster for the job market in America. Millions of jobless workers need extended unemployment compensation and emergency action to protect lost health care protection for themselves and their families.

Community Development Supplemental Jobs—We propose a large-scale community development jobs program with 100 percent federal funding for jobs directly on the regular, local government payrolls. Unlike previous public sector jobs programs, specifically the CETA program, these jobs would not be in a separate category. Measures would be included to prevent substitution for regularly employed workers.

In every community, there is work to be done that is vital to that community's economic health and public well-being but which has been neglected. Because of declining tax revenues, federal budget cuts and local government fiscal crises, many of these communities need help to repair, maintain, and rehabilitate essential public facilities and public services.

For this purpose, we urge a supplemental appropriation of $5 billion for fiscal year 1983 and an appropriation of $10 billion for fiscal year 1984.

Accelerated Public Works—Investment in accelerated public works can provide jobs and essential infrastructure underpinning for private sector investment and economic growth. The Surface Transportation Assistance Act of 1982 is only a start in the right direction. For years this nation has lived off its public capital instead of replenishing it. We have shortchanged investments in needed public facilities related to health, education, energy, safety, solid waste removal, water supply, parks, highways, bridges, ports, railroads and urban mass transit. The result is a huge backlog of unmet public capital needs and a major impediment to growth and a return to the nation's full productive potential. The crucial role of public capital formation is too often ignored. Such public investment plays a key role in raising the nation's productivity and output. Experience in the 1960s and 1970s—particularly in the 1975 recession—demonstrates that accelerated public works can provide jobs quickly and economically while restoring economic growth.

For such a program, we urge a supplemental appropriation of $5 billion in fiscal year 1983 and an appropriation of $10 billion in fiscal year 1984.

Housing Construction and Rehabilitation—In past recessions, housing was revitalized through such programs as below-market interest rate subsidies and rental assistance for low income households. But the depth and length of this recession has seriously worsened the underlying problems of housing inadequacy and affordability. A program which provided support for the construction of 170,000 new housing units a year—about the level of assisted housing starts in the 1970s—could make a significant contribution to closing the housing gap. In addition, Congress should enact legislation to provide home mortgage relief and rental assistance for jobless workers in danger of losing their home or being evicted.

For these purposes, we urge a supplemental appropriation of $5 billion in fiscal year 1983 and an appropriation of $10 billion in fiscal year 1984.

Youth Programs—Two million American teenagers are unemployed—including half of all black teenagers in the workforce, and one of every four teenagers overall. Youth employment and training needs are too often slighted in programs aimed at older workers. Expansion of the successful Job Corps, establishment of a new youth conservation corps, and other employment and training projects are needed to alleviate the special problems of jobless youth.

The AFL-CIO remains adamantly opposed to subminimum wages for workers of any race, sex or age. A long history of studies and pilot programs have reached the same conclusion as then Secretary of Labor George Shultz did in 1970: there is no evidence of any appreciable increase in jobs because of a subminimum wage.

For the youth program, we urge a supplemental appropriation of $1.5 billion in fiscal year 1983 and an appropriation of $3 billion in fiscal year 1984.

Dislocated Workers—Supplemental funds should be allocated to the new Job Training Partnership Act's program to help workers hit by plant closings and major layoffs. These workers need a variety of pre-layoff assistance and services, as well as training, to help them move back into regular jobs.

For this purpose, we urge a supplemental appropriation of $1 billion in fiscal year 1983 and an appropriation of $2 billion in fiscal year 1984.

Unemployment Insurance—To replace the present supplemental benefits program expiring March 31, 1983, Congress should enact a permanent program of supplemental unemployment insurance, funded by general revenues, with a maximum duration of not less than 65 weeks. The 6.27 million jobless workers now on unemployment compensation are the most in the history of a system dating to 1935. Still, only half of the 12 million officially unemployed are getting any unemployment benefits.

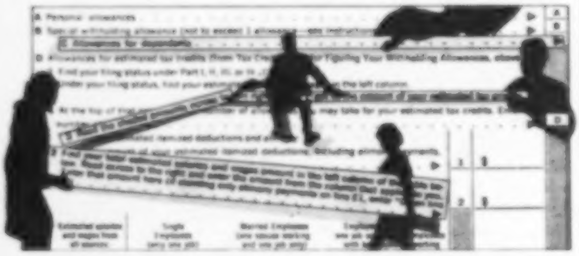
Since July 1981, more than five million workers have exhausted their regular UI benefits and another one million long-term jobless workers have lost their extended benefits. Of the 900,000 unemployed workers getting federal supplemental benefits, 135,000 have already exhausted or will soon exhaust these benefits. The remaining 765,000 will run out of benefits in the coming weeks. The drastic cutbacks in the extended UI benefit program means that these extended UI benefits are available only in about half of the states despite catastrophic unemployment levels.

To meet the urgent need of long-term jobless workers, we urge a supplemental appropriation of $2 billion in fiscal year 1983 and an appropriation of $6 billion in fiscal year 1984.

Health Care for the Unemployed—Since health insurance coverage is usually tied to the workplace, Labor Department statistics indicate 50 percent of laid-off workers lose health care protection immediately or one month after layoff. Only 20 percent get coverage for three months or more. Since the average duration of unemployment is a little over four months, most jobless workers can expect to be completely without health insurance protection. At the same time, most unemployed workers are denied Medicaid coverage because they have not been poor long enough to meet the state eligibility criteria.

We urge the necessary authorizing legislation and a supplemental appropriation of $3 billion in fiscal year 1983 and an appropriation of $5 billion in fiscal year 1984 to assure health insurance coverage and health services for unemployed workers and their families.

In summary, we are calling for supplemental appropriations of $22.5 billion in fiscal year 1983 and an appropriation of $46 billion in fiscal year 1984 to create jobs, to stim-



AFL-CIO ECONOMIC PROGRAM FOR JOBS AND FAIRNESS

BILLIONS OF DOLLARS

This table details the deficit reductions possible through the AFL-CIO program. The combination of tax measures and defense savings over the 1984-1986 period add up to over $300 billion and most of these savings would continue in later years. The cost of programs to create jobs, help the unemployed and restore fairness add up to essentially a one-time increase in expenditure of $87.8 billion. Deficits would also be reduced as employment gains create additional incomes and tax revenues.

INCREASED REVENUES & SAVINGS

Taxes	Fiscal Year (Billions) 1984	1985	1986
$700 Cap—third year	$ 6.0	$ 6.9	$ 7.4
Repeal Indexing	0.0	8.9	23.4
Trim "Savings" Exclusions	0.6	1.7	3.7
Phase Down Capital Gains Exclusions	2.5	5.6	8.1
Scale Back Estate & Gift Tax Exclusions	1.6	2.1	2.8
Foreign Tax			
DISC	2.0	3.0	3.0
Deferral	6.0	6.6	7.1
Foreign Tax Credit	6.5	7.1	7.4
Investment Tax Credit			
Depreciation Basis Adjustment	1.3	2.4	4.1
Reduce 10% to 7%	5.6	7.1	8.2
Limit Graduated Rates to Small Corporations	1.9	2.0	2.0
Oil & Gas Depletion & Expensing of Drilling Costs	7.2	8.0	9.0
	$41.2	$61.4	$86.2
Defense			
5-7% Surcharge	$11-$15	$23-$32	$37-$52
Lower (5-7%) Real growth	5-3(14)	17-7(31)	25-13(33)
Total Taxes & Savings	**$57-$59**	**$101-$100**	**$148-$151**

INCREASED BUDGET OUTLAYS

Jobs & Recession Relief	Supplement to FY 1983 (Billions)	1984	Direct Jobs (thousands) 1983	1984
Comm. Development Supplemental Jobs	$ 5.0	$10.0	420	835
Youth Programs	1.5	3.0	215	430
Displaced Worker Program	1.0	2.0	—	—
Housing	5.0	10.0	85	180
Accelerated Public Works	5.0	10.0	170	340
Extended Unemployment Insurance	2.0	6.0	—	—
Health Care for the Unemployed	3.0	5.0	—	—
	$22.5	$46.0	880	1,785
Rescind Proposed Budget Cuts in Non-Defense		19.3		
TOTAL INCREASED OUTLAYS	**$22.5**	**$65.3**		

*Progressive defense surcharge on individual and corporate income tax to pay for increases in real defense spending starting in July 1984 — increases reflect 5%-7% real growth.

**Defense savings represent a reduction in real defense outlays from those proposed by the Reagan Administration to a real growth level of 5% to 7%. Budget authority numbers are in parenthesis. Outlays frequently reflect previous authorizations and continue or phase out programs from earlier years plus day-to-day operations.

ulate the economy and to ease human suffering and hardship.

BUDGET CUTS

In 1983, as in 1981 and 1982, the Reagan Administration is proposing drastic cuts in federal programs that help workers, elderly people and children, the poor and the needy.

The AFL-CIO calls on Congress to reject the President's $19 billion cut in non-defense programs from current service levels and to appropriate sufficient funds for protection of the unemployed, and the needy, and for education and training to get the nation back on track to full employment.

Reagan Administration budget cuts for fiscal 1984 strike at a range of key social and economic programs. For example:

- Job training and employment funds are to be cut.
- Unemployment compensation funds are reduced.
- Trade Adjustment Assistance is to be killed.
- Education, student loans, compensatory education for disadvantaged, vocational and adult education are cut.
- Housing programs for low- and moderate-income families suffer deferrals, stretch-outs, and cutbacks.
- Federal employee pay and retirement benefits sacrificed.
- Aid for the poor is cut $12 billion in Medicaid, food stamps, child nutrition, Aid to Families with Dependent Children, and low-income energy assistance.
- Medicare and other health services take cuts.
- Revenue sharing with state and local governments is further tampered with.
- Railroad retirement increases postponed.
- Mass transit and other transportation programs are reduced again.
- Legal services for the poor are killed.
- Mine safety and health inspectors are cut.
- Environmental protection funds are drastically reduced.

Federal budget cuts in programs administered at state and local government levels have left those governments with inadequate resources to provide essential services. These federal budget cuts not only hurt people who suffered reduction of program services, they also placed additional burdens on already strained state and local government resources. There were transfers of program responsibilities to states in the form of consolidated block grants for a whole area, such as education and health, while cutting back on total funds to perform the functions, or increasing the amount by less than needed to match inflationary cost increases. Such actions were further aggravated by eliminating revenue sharing funds going to the states and freezing the amount of revenue sharing going to the cities, so that the effectiveness of such funds was decreased by inflation. The federal government has a responsibility to provide relief.

TAXES

The 1981 Reagan tax cut was irresponsible and unfair. It is damaging the economy and undermining fairness and equity in the nation's tax structure. In 1982, Congress, shocked and embarrassed by the bizarre examples of tax avoidance and huge revenue drain, pushed through a complex array of tax changes and increases that restored some revenue and curbed some of the more blatant giveaways of the Economic Recovery Tax Act of 1981 (ERTA).

The 1982 Tax Equity and Fiscal Responsibility Act (TEFRA) phased out the previous year's safe harbor leasing gimmick whereby business bought and sold tax write-offs; it extended the principle of payroll withholding to interest and dividends, and it strengthened the minimum tax provision so that those with large amounts of tax sheltered income shoulder a little more of the nation's tax burden.

These 1982 measures restored only a small part of the revenue and equity lost in the 1981 "supply side" giveaway to the rich and the corporations.

Thus, $92 billion, or half (49 percent), of the $189 billion 1984 deficit can still be traced to the Reagan tax cut even after accounting for 1982's corrective action. For the three-year 1984-1986 period the Administration's proposed cumulative deficit is $531 billion and its tax program, even after the changes made in 1982, will still drain $358 billion, or two-thirds of this projected deficit, from the Treasury.

These deficits, past and prospective, are obviously not the result of government overspending, or consciously stepping in to strengthen the economy. They are the direct result of trying to boost the economy through senseless and unfair tax cuts while sapping its lifeblood through sky-high interest rates.

The fairest and most sensible way to deal with revenue needs and equity issues is to complete the job of patching up the damage from the 1981 tax giveaway and to embark on a long-overdue program to close loopholes and put federal revenue-raising back on an equitable basis.

$700 Cap: If Congress does not act, on July 1, 1983, the third installment of the Reagan Administration's 5-10-10 percent tax cut will go into effect. Its cost will be about $30 billion. Ten billion dollars will flow into the pockets of the wealthiest and most privileged members of our society.

That $10 billion is just about equal to the amount of money the President would squeeze out of food stamps, Aid to Families with Dependent Children (AFDC), Supplemental Security Income (SSI), and child nutrition programs over the next five years.

A family of four with income of $100,000

($ Billion)

	1983	1984	1985	1986	1984–1986
ERTA	$ −82.6	$ −130.3	$ −158.2	$ −202.3	$ −490.8
TEFRA	+17.3	+38.3	+42.2	+52.1	+132.6
Net Revenue Loss	$ −65.3	$ −92.0	$ −116.0	$ −150.2	$ −358.2
Percent of Deficit	31.4%	48.7%	59.7%	98.3%	67.5%

Source: Budget U.S. Fiscal Year 1984

a year would receive $2,400 per year in tax reductions—on top of $4,500 per year from the first two installments. In sharp contrast, a $30,000 working family would receive a cut of $340, and a family earning $20,000 would only get $175 from the July cut.

A tax cut of such size and distribution is unconscionable and the third installment must be limited. With an appropriate cap, no taxpayer would get more than $700. Capping the total tax reduction in such a fashion will have little or no effect on income under $45,000, so it does not risk reducing consumer demand or otherwise weakening the economy. The revenue gain would be $6 billion in fiscal year 1984, and total $21 billion for the three years 1984 through 1986. At the same time, the income tax would become somewhat more equitable as the giveaway to those at the top is reduced.

H.R. 1183, a bill to limit the individual tax cut of 1983 to $700, was introduced February 2, 1983, by Representative Guarini of New Jersey with co-sponsors including Representatives Wright of Texas, Foley of Washington, and Gephardt of Missouri.

Repeal Indexation: Another way to raise revenues while strengthening the economy is to repeal the indexation provisions of the ERTA that will take effect in 1985. An indexed tax code means a sharp limitation on the ability of the federal government to manage the economy. It amounts to a permanent and continuing erosion of the tax base regardless of economic need or circumstance. Repealing the indexation provision would save $8.9 billion in fiscal year 1985 and $23.4 billion in fiscal 1986.

"Savings Incentives": The 1981 Act contained a number of provisions which would supposedly reward savers. These devices—interest and dividend exclusions, individual and self-employed retirement accounts and the like—erode the equity of the tax structure by benefitting primarily those who can afford to save. Moreover, individuals and families in higher tax brackets receive greater benefits. Any small tax reduction that flows to moderate and middle income Americans is overshadowed by the competition for funds and the ratcheting up of interest rates that these devices cause.

Beginning in 1985, 15 percent of interest income that exceeds non-mortgage interest expense will be tax exempt up to $6,000 ($3,000 single). Repeal of this exclusion would save $.6 billion in fiscal year 1984, $1.7 billion in 1985 and $3.7 billion in 1986.

Individual Retirement Account provisions should be made more equitable and less costly by changing the off-the-top exclusion to a credit providing the same dollar amount to all "savers" regardless of their tax bracket.

Capital Gains: The 60 percent exclusion of profits from the sale of stocks, bonds, real estate or other capital assets and the total tax exemption of such gains when passed on to heirs fundamentally violate the concept of tax equity.

The 60 percent capital gains exclusion is an $18 billion a year revenue loser, and the top 5 percent of the nation's taxpayers get 60 percent of the benefit. Cutting the exclusion back to the pre-1979 50 percent level would raise $2.5 billion in 1984, and beginning on a 5-year phasedown of the exclusion in 1985, with adequate protection for homeowners, could raise over $16 billion in the 1984-86 period.

Estate and Gift Taxes: The 1981 Revenue Act essentially repealed the Estate and Gift Tax. Sharp cuts in rates and increased exemptions and credits cut the revenue from this tax so drastically that by 1986 this tax on the transfer of wealth will account for only one-half of one percent of federal revenue. The 1981 cuts should be repealed and the estate and gift tax should be restored to its former structure, which allowed $250,000 or one-half of the estate (whichever is greater) to be passed on to the surviving spouse tax free and provided generous credits for other heirs.

Scaling back estate and gift tax exclusions could generate $3.2 billion in FY 1984, $4.2 billion in 1985 and $5.6 billion in FY 1986.

Corporate Taxes: The corporate income tax should be reinstated as a source of revenue, equity and economic balance. Corporate income tax receipts for the 1983 and 1984 budgets are estimated at $35.3 and $51.8 billion respectively. At this level, the tax amounts to only 5.9 percent of total 1983 budget receipts and 7.8 percent of anticipated 1984 revenue. In 1980 the ratio was 12.5 percent, and in 1970 it was 17 percent. In 1960—before the enactment of depreciation speed-ups, the investment tax credits, and rate reductions—the corporate income tax financed nearly 25 percent of the total federal budget. If the corporate income tax were to bear the same share of the federal tax burden in 1984 as it did in 1980, receipts would be $30 billion higher.

Tax subsidies encourage the overseas operations of U.S.-based multinational corporations. These preferences have eroded the tax structure, destroyed American jobs, and spurred the outflow of U.S. capital, technology, and know-how.

- **Foreign Tax Credit:** The present practice of allowing dollar-for-dollar credits against a multinational company's U.S. income tax liability is a loophole which encourage U.S. corporations to produce abroad. Foreign taxes should be deducted just like other costs of doing business.

- **Deferral:** The deferral privilege allows multinational corporations to defer U.S. income tax payments on the earnings of their foreign subsidiaries until such profits are brought home—which may never occur.

- **DISC:** Elimination of the Domestic International Sales Corporation (DISC) which allows corporations to spin off income and profits into export subsidiaries in order to defer, perhaps indefinitely, taxes on export profits.

Ending these three foreign tax subsidies would raise $14.5 billion in revenue in FY 1984 and $48.7 billion in the 1984-1986 period.

The Investment Tax Credit: In 1982 Congress went halfway toward eliminating the practice of deducting, as depreciation allowances, costs that were already deducted as investment credits. If the job were completed and business were required to reduce the depreciation base by the full ITC rather than only one-half, $1.3 billion would be recaptured in FY 1984 and $7.8 billion over the three-year 1984-1986 period. Cutting the credit back from 10 percent to its previous 7 percent level would raise $5.6 billion in FY 1984 and $20.9 billion in the 1984-1986 period.

The "Small Business" Rate: Under present law, the first $100,000 of corporate net profit is taxed at a maximum of 26.75 percent. This low rate, justified as a device to cut taxes on small business, also applies to large corporations. Moreover, the largest corporations receive the lion's share of the tax break. Limiting this lower rate to smaller corporations (phased out between $100 and $200,000) would raise $1.9 billion in FY 1984 and $5.9 billion in the three-year 1984-1986 period. It should also help the competitive position of smaller businesses.

Oil and Gas: High on the list of unfinished business is the elimination of the special tax loopholes for the oil and gas industry. Eliminating percentage depletion and the immediate expensing of drilling costs would increase revenue in 1984 by $7.2 billion and generate a cumulative revenue increase of over $24 billion during the 1984-1986 period.

Various tax proposals spelled out in the Reagan Administration's FY 1984 Budget would further erode the fairness, simplicity, and the productivity of the tax code.

Tuition tax credits are trotted out again and a new "Individual Education Account" gimmick is floated despite the deficits and the need to improve funding for educational opportunities accessible to all citizens, including the disadvantaged.

An estimated $135 billion in corporate tax reductions will accumulate during the 1982-1986 period due to the 1981 changes in depreciation allowances. This massive revenue giveaway did not generate the expected boom in investment, output or employment. Instead, the economy sank into the worst recession in the post-war period. Accordingly, there is no reason to provide further so-called "incentives" to the corporate sector.

The problem of urban economic decay will not be solved by or through the so-called enterprise zones which have been proposed by the Administration. These zones would do nothing to stimulate overall economic development. Instead, they would merely encourage business tax cuts, plant piracy and a reshuffling of workers and jobs.

The Administration proposes tax workers' health insurance premiums above $175 a month for a family and $70 for an individual. This will particularly hurt older workers, handicapped workers, workers with large families, workers exposed to harmful chemicals and other industrial hazards—in fact, anyone with large health care costs.

The so-called "contingency tax," proposed by the Reagan Administration to assuage the fears of the financial community about monstrous deficits in the future, would probably have the opposite effect. Uncertainty about the future would be aggravated, not dampened, by such a "tax." It would not touch the billions of dollars that escape the tax base through inappropriate exclusions, tax shelters, write-offs of phantom costs, and overseas tax havens.

The federal government's fiscal problems—in large part the result of tax injustice—have ironically touched off an array of proposals for "simplification" and reform which in fact would shift even more of the tax burden to low- and middle-income Americans.

Such proposals include a national sales tax, a flat tax or measures to further diminish or eliminate the corporate income tax. In short, we reaffirm our support for a tax structure firmly grounded on the principle of ability to pay.

Senator CHAFEE. Thank you very much, Mr. Cantor.

I don't have any questions. We have had the opportunity and privilege of reviewing your testimony. You testified of course here last year when we were considering this.

Senator Long, do you have any questions?

Senator LONG. I notice, Mr. Cantor, that you do favor establishment of a Reconstruction Finance Corporation. I think I agree with you on that. In fact, I even asked that my name be added as a sponsor on the bill.

But one thing does concern me. I think that if we are going to have the Federal Government making loans and guarantees, we ought to see, as a part of that, that employees would own stock in the company.

I took an interest in the Chrysler guarantee program, and as a part of that, we insisted that the employee should have some stock in the company. Now I am pleased to see that the company is now a success, doing great. It is showing about a $160 million profit.

Mr. CANTOR. Morning's headlines.

Senator LONG. By yesterday's news, it is doing very fine indeed. That stock is now worth about four times what it was when that arrangement was made. It was that before they announced this profit.

My guess is that it won't be long before that stock will be worth 10 times what it started out to be. The employees have about 15 percent stock in the company.

I would hope that your people would support my efforts to see to it that if the Government is going to get involved and take the risk, or share a great portion of the risk, which is in effect committing the credit of 230 million taxpayers or citizens to this enterprise, then the employees ought to own a piece of it and have a stake in it. I just wonder how you feel about that.

Mr. CANTOR. Well Senator, for the Chrysler situation, as you do know, the labor movement, the automobile workers did make a considerable sacrifice and contribution to the whole Chrysler package.

I am a little sort of—I am fishing for words—let's call it eclectic on employee stock ownership plans, Senator, and mainly because it is hard for me, when I have looked around at many, many, many of these, it is hard to categorically be for them or against them. I think in certain situations they make a lot of sense. In certain situations, as you well know, they have been exploited as bailouts for small corporations to avoid estate taxes. In certain cases I think they have made an excellent contribution to helping the package of benefits, in addition to pensions.

So I really have a great deal of trouble categorically saying yes or no.

Senator LONG. You have been more negative about the idea of employees just owning a piece of the action than anybody in organized labor, you yourself, Mr. Cantor.

To me, I don't see anything wrong with labor becoming so successful that they wind up owning the whole blamed thing. I mean there is nothing wrong with that as far as I am concerned. And I am not aware of any situation where the workers ever put the union out just because the fellows got lucky and wound up owning their company.

Mr. CANTOR. No, Senator, that has never been our reasoning and my reasoning. The feeling has always been—I remember my late very, very dear boss, George Meany, saying that if a worker wants to own stock in the company, his paycheck should be high enough so that he can afford to go out in the stockmarket and buy it.

Now my only reservation, and I mean this very sincerely, Senator, on the question of employee stock ownership is the notion of bringing the Federal tax structure and the Federal Government into the equation. I have no problem with privately negotiated plans, with local plans, with employers and employees getting together to see how they can cooperate and share the action.

I have had some reservations all along with how the tax structure should be pulled into this notion. And that is all, sir.

Senator LONG. Well, let me just make the point, Mr. Cantor, and I haven't had occasion to discuss this matter with you individually, as I would like to do on future occasions, because I think maybe we will have occasion to talk about it more times than one. I would like that because I am very much interested in this approach.

I have been trying to sell this approach, and I think I have my own labor movement in Louisiana pretty well sold on the idea. Victor Bussie is an outstanding State president of the Louisiana Federation of Labor and I have Victor Bussie sold, I think, that it is a good idea.

There are many situations where you can get some stock for these workers if the representative would just ask for it, just ask for it. And it need not be by sacrificing something else. Just put it down at the end of the shopping list, if they must, so that by the time they get through they say oh yes, there is one more item: I would sort of like to own some stock in the company. You would be surprised how often you get something if you just ask for it.

Mr. CANTOR. I have no problem with that, Senator, really and truly.

Senator LONG. Now you see, if I had thought about it back at the time that we had that Lockheed loan, I would have offered an amendment to say that while the Government is going to help Lockheed, the employees should share as well.You know, the Government didn't lose any money. We saved the company and saved ourselves a lot of money because it would have cost us a lot of revenue for Lockheed to go broke.

If we had said all right, if the Government is going to get involved in this, we would like the employees to have some stock in it, I think that we could have easily gotten maybe 25 percent of the risk we were taking, something like that financed through an employee stock ownership plan.

I am convinced that more and more you are going to see that you are getting more productivity where those workers own a substantial equity position in the company for which they work. It tends to reduce the confrontation. Both sides tend to respect one another.

Furthermore, it is amazing what good businessmen workers tend to be when they own a piece of the action. I guess you are familiar with what happened in the Chicago and Northwest Railroad. That union leader tried to get these fellows to all go with him to buy that railroad and everybody who could get involved did and every nickel they could beg and borrow they put into it. That stock today is worth 50 times what they paid for it—at least that is what I am told, and I believe it is correct.

When they first did this, a lot of the employees did not participate. But later on, after they got the thing going, a lot of them said you know, we have been thinking about it and we think it is a good idea after all. We would like to buy in. The fellows who were in it already called a meeting and they said, these other fellows now want to come in. Shall we take them in? They agreed to let them buy in. Well, they asked, what price shall we charge them? Shall we charge them the same price we paid, or what it is worth now? And those fellows answered, we took the risk and put our money into it; they can pay what it is worth now.

Later on the same thing happened a second time, with a new group who wanted to buy in. They held another meeting and asked the same question a second time. The second tier of owners gave the same answer: if those new guys are going to come in, they have to pay what the stock is worth now.

This just indicates that labor fellows become businessmen in a hurry once they have an equity position.

I think a labor union that is there is going to stay there and it doesn't go out just because the employees happen to own an equity position, even if they own it all. So I don't think there is a conflict between employees owning something and working for the company in which they own stock.

I hope you don't find it that way because I think that in the end, the future for labor is going to be more and more that labor becomes a very important part even of making management decisions, where at least they have occasion to think about it, because in the last analysis, nobody knows better whether you have good management than the guys who work for the company.

Thank you very much for your testimony.

Senator CHAFEE. Mr. Koplan?

Mr. KOPLAN. Yes, Senator, I just wanted to make one very brief comment with regard to a suggestion for a Reconstruction Finance Corporation. I would just mention that there is a bill that has been introduced in the House, H.R. 134, that reflects the kinds of things we are talking about with regard to the Reconstruction Finance Corporation.

In that bill, there is a requirement that in order for the company to receive financial assistance, it should submit a written request for that assistance, together with a plan as to how they are going to use that money. There are about six criteria that ought to be included in the plan.

I would just suggest to the committee—I am not going to take the time to read that into the record now, but if, during the course of its consideration, the committee might compare the types of criteria that we are suggesting for loans, loan guarantees and direct interest subsidies, and compare that to the criteria in the legislation that is before the committee now, to see where our differences are.

Senator CHAFEE. Thank you.

Well, I can't help but express some disappointment that the AFL-CIO is not prepared to support something as an experiment. I don't think that anybody has suggested this as the savior, that this is a panacea. It is a very modest start. You have heard a parade of witnesses, those who are out there on the firing lines—the mayors, the black mayors, somebody representing the Black Mayors Conference, those right out in the tough districts such as Representative Garcia from the Bronx.

Here we have been working on this for quite a while. We have tried to accommodate some of the difficulties presented by labor. We are sorry that we couldn't get you to wheel behind us. Well, we will see how it comes out.

Mr. **Cantor**. Senator, if I may, I know you are pressed for time but I would like to make a point that we have gone over this, as you have said, many, many times for several years. I don't like the AFL-CIO to be put in the position of always being negative here and I would like to emphasize that we really and truly feel that the concept is flawed. The Treasury this morning was very emphatic. They said flat out, "* * * the largest barrier to economic growth is excessive Government regulation."

Sir, if we are drafting a bill that begins with that premise, I think we should give up the act. The concept is flawed. We have to look at a different kind of concept. I cannot believe that is the problem. I cannot believe that the Federal Government should use its offices to encourage State tax cuts, which is also what this bill is about.

We are in favor of "enterprise" in urban areas. We have supported every single urban program coming down the line. We have argued for the Area Redevelopment Act. We have argued for the Economic Development Administration. These are measures which are palpable. These are things that can do something.

This bill is encouraging just the opposite of what should be done. The concept is bad, sir.

Senator **Chafee**. Well, we could debate this out. As Senator Long said, he is looking forward to some discussion with you.

There are several points I would make. One, we have tried a whole series of measures—UDAG, EDA, Community Development Block Grants—you name them, we have tried them. We have poured literally billions of dollars into these cities. And we still haven't solved this knotty problem which was referred to by Representative Garcia with the quote from Robert Kennedy, "If you look at the statistics on inner city unemployment we really are no further ahead."

So we say let's try something different.

The other point is that what you say is let's do more of what we have done in the past, or let's try some experiments that really aren't going to pass. You can say there should be a new RFC, but I don't think any of us sitting in this room believe that that is going to pass this Congress, either the House or the Senate.

In any event, we thank you for coming. You have genuine, deep feelings about this matter which you have eloquently set forth, and we are grateful to you for taking the time to come here and testify.

Mr. **Parente**. Could I add one point to what was just said?

Senator **Chafee**. Sure.

Mr. PARENTE. Just a quick point. I don't know that it is true that all of our past efforts have been unsuccessful. We would say that a lot of the things that we have done have made a contribution to improving conditions.

Just to cite one example, in the area of housing, we have provided millions of units of subsidized housing for people that serve them right now. This production of housing has helped to reduce the amount of housing in the country that is substandard. This has been a successful effort.

The problem now is that in many program areas, they are not adequately funded, so that they can't continue to make the contributions that they have in the past. To cite two specific examples, the UDAG and the block grant program, those are programs that would compete for the funds that would go to the enterprise zones. And although enterprise zones are just an experiment, the aggregate amount of the tax expenditures would be considerable over a period of time. We heard the figure of $3.3 billion between 1984 and 1988.

Senator CHAFEE. Again, we thank you for coming. Of course I want to acknowledge what has been achieved with the subsidized housing. I was particularly addressing the jobs problem.

Thank you gentlemen very much.

The next panel has Mr. Granados, Mr. Ainslie and Mr. Zdenek. Why don't you all come forward as a group.

Why don't Mr. Rachels and Mr. Jackson come forward, too? Sit down and we will take you in order. I know Senator Long is very interested in the ESOP's, so why don't you start, Mr. Granados?

STATEMENT OF LUIS GRANADOS, MANAGING DIRECTOR, THE EMPLOYEE STOCK OWNERSHIP ASSOCIATION, WASHINGTON, D.C.

Mr. GRANADOS. Thank you, Senator.

I would like to thank Senator Long for giving my testimony for me about the value of employee stock ownership plans, sparing me the effort.

ESOP companies are different in that they do create an incentive for the workers and the owners to work together to achieve a common objective, which does not exist in the typical company. And the studies that have been done show that this incentive does improve productivity. While national productivity rates have been going down in the last few years, productivity rates among ESOP companies have been going up.

This is reflected in profitability. The profitability of ESOP companies, studies show, is 50 percent higher than the profitability of similar-sized companies in similar industries.

If you want to do something to stimulate private enterprise in enterprise zones, ESOP is really the way to go, and what is needed are the sorts of things that are in Senate bill 634 and the sorts of things that are in legislation that Senator Long has been advocating over a number of years to provide a fairer, more reasonable tax treatment of these programs.

The one item I want to mention today has to do with the matter of the treatment of dividends that are paid to the ESOP. Our members tell us that it is very difficult to communicate the concept of ownership to their employees when all the employee gets each year is a piece of paper that says that some day when he leaves the company, he is going to receive some stock, and there is no guarantee as to how much it is going to be worth.

What is much more powerful is to be able to pay the employees dividends—pay the ESOP the dividend, pass the dividends through the ESOP to the employees, and then the person gets a check. When you are at or near the poverty level, a cash dividend is a particularly important thing to be able to have.

Some companies do that now, but it is really, under the current tax laws, economically suicidal to do that because the company doesn't get a tax deduction for the amounts that it pays to the ESOP and passes through. It boils down to this: If you pay a person $1 and call it a wage, you get a tax deduction for it. If you pay the same person the same dollar for doing the same thing and say well, that is a dividend, then you don't get a tax deduction for it.

The net result is that companies pay fixed wages; they don't pay variable dividends; the employees don't really feel that they are sharing in the fruits of ownership, and the ESOP doesn't achieve the full potential that it might be able to achieve.

By giving a tax deduction on the dividends paid to the ESOP and passed through, as Senator Long has been talking about for a number of years, with a very limited revenue impact, we can make the ESOP work a lot better than it does today.

As far as we are concerned, that would be the single most valuable item in Senate bill 634.

Thank you.

[The statement of Mr. Granados follows:]

The
Employee
Stock Ownership
Association

The ESOP Association
1725 DeSales Street N.W.
Suite 400
Washington, DC 20036
202-293-2971

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TESTIMONY OF LUIS GRANADOS

MANAGING DIRECTOR OF THE ESOP ASSOCIATION

SENATE FINANCE COMMITTEE

April 22, 1983

My name is Luis Granados. I am the managing director of the Employee Stock Ownership Association, which is the national nonprofit organization of companies with Employee Stock Ownership Plans — "ESOPs", for short. We support the sections of Senate Bill 634 dealing with tax changes for employee stock ownership plans in enterprise zones. In fact, we believe that these changes should not be limited to enterprise zones, but should be implemented on a nationwide basis.

We agree wholeheartedly with the President's philosophy that the best way to help those in distressed areas is not to give them handouts, but to bring them into the mainstream of the private economy. Everything that is consumed must be produced. For people in these areas to consume more, they must produce more. However, as Louis Kelso, the inventor of the ESOP, has pointed out, production is no longer simply a matter of laboring with your hands. Production, today more than ever, involves the use of productive capital as well as productive labor. That's where the ESOP comes in: it enables average working people to acquire a portion of the ownership of the places where they work, thus enabling them to produce through their ownership of productive capital as well as through their own labor.

This uniting of the factors of production has a great impact on the day to day operations of a business enterprise. In the typical company, where the people who supply the capital are different from the people who supply the labor, there is a destructive tension that undermines the functioning of the enterprise. Everyone knows that what's best for the company is not what's best for the employees, and what's best for the employees is not what's best for the company, and they fight their daily battles with each other accordingly. That's no way to get a job done. With an ESOP, on the other hand, people have the incentive to pull in the same direction, because what's good for the capital side of the company is also good for the labor side of the company. That's why the studies show that while national productivity rates have been dropping in recent years, productivity among ESOP companies has been rising. And productivity means profits: the profitability of the ESOP firms studied averages 50% higher than the profitabilty of similar sized firms in the same industries.

The concept of employee ownership of both of the factors of production has particular importance in the context of trying to stimulate production in areas where over the years a great hostility has grown up to the private enterprise system. Not without some justification, many people in these areas believe that the system is stacked against them, and that there is no point in trying to participate in that system because it will never really let them get anywhere. Simply providing low paying jobs with the profits flowing somewhere else is not going to break that hostility. But providing substantial, meaningful ownership of productive capital along with those jobs is another matter. When your next door neighbor brings home a five hundred dollar dividend check representing his share of the company down the street's profits, that may color your thinking somewhat about the role of the company down the street!

There is one provision in S.634 that would be particularly helpful in achieving the benefits of broadened capital ownership in these areas, and it (Section 402) has to do with this matter of dividends. Although the ESOP does have a strong impact on employee motivation and productivity, our members tell us that it is often difficult to communicate to their employee owners what stock ownership is all about. After all, in the typical case, all the employee gets is a piece of paper saying that he's going to get some company stock someday when he leaves, with no guarantee as to what it will be worth at that time. For people with a deep seated suspicion and hostility toward private business in general, a piece of paper like that isn't terribly meaningful. What is a lot more powerful, especially for people at or below the poverty level, is a check that they can spend. When a company tells its employee "We made a profit last quarter and here is your share of it; next quarter you'll get another check that will be either higher or lower depending on how well we do" — that has an impact on motivation and productivity.

Of course, companies can do that now, and the ESOP can pass through those dividends to employees currently. But it is economically suicidal to do so, because those dividends paid and passed through to employees are not tax deductible. If the company pays an employee a dollar and calls it a wage, it gets a tax deduction for it; but if it pays the same fellow the same dollar for doing the same thing and calls it a dividend, it gets no such deduction. The net result is that employees get fixed wages, not variable dividends, and they don't see themselves as sharing in the fruits of ownership, and the ESOP doesn't achieve its full potential. Section 402 of the bill, as well as other legislation that Senator Long has introduced, would correct this problem by giving the employer a tax deduction for dividends paid to the ESOP and passed through currently to employees.

Moreover, the current tax treatment of ESOP dividends hits employees coming and going. When the dividend is paid to the ESOP, the IRS calls it a dividend and says it is not tax deductible to the company. But when that dividend is passed through to employees, the IRS says it is not a dividend, it is a "distribution from a qualified plan", and therefore it is not eligible for the $100 dividend exclusion available to everyone else. We don't think it makes sense for the tax laws to discriminate against employee ownership in this way.

ESOPs by themselves are not going to solve all of America's economic problems, and they are not going to turn depressed inner city areas into utopias of cheerful workers accumulating huge capital estates. They are, however, a sensible way to organize a business, and are the best possible hope for changing the attitudes of those who feel they are frozen out of the free enterprise system as it exists today. To make them work, we don't need government subsidies, we need sensible tax policies that treat the economic realities of the ESOP fairly. This Committee has been well attuned to the potential of the ESOP in the past, and I hope that you will continue to be mindful of this potential in this and other tax legislation this year.

Senator **Chafee**. Thank you very much.

Now of course that problem is not specific to the matter before us now.

Senator **Long**. But he would like to provide this as an answer in these particular zones.

Senator **Chafee**. Oh, I see.

Mr. **Granados**. We would like to see it nationally. The bill that the committee is hearing today provides it just in the enterprise zones.

Senator **Long**. We already provide for subchapter S corporations, and we have permitted them now to expand the membership to 35 shareholders, as I recall it, in subchapter S corporations where they are taxed as a partnership, even though they are organized as a corporation.

Now if we think that is a good idea and if we want to provide more effective organization and more incentive to do things in these enterprise zones, the employee stock ownership arrangement in those areas, as you are suggesting, could be where you are treating that dividend to the employee just the same as you do in a subchaper S corporation. In effect, you are saying in these enterprise zones, you don't double tax the profit. You treat the dividend just as if that were the wage that the worker is making for tax purposes.

Mr. **Granados**. Exactly, Senator Long. The money is still taxed. It is just taxed at the individual level, rather than at the corporate level.

Senator **Chafee**. Thank you. Mr. Ainslie.

STATEMENT OF MICHAEL L. AINSLIE, PRESIDENT, NATIONAL TRUST FOR HISTORIC PRESERVATION, WASHINGTON, D.C.

Mr. **Ainslie**. Thank you, Senator Chafee, Senator Long.

I am here representing, as you know, the National Trust and our 1,600 preservation organizations around the country. Increasingly, these are neighborhood organizations, many of them in inner city lower income communities that are concerned with the issues that the Enterprise Zone bill presents or attempts to address.

We have worked very closely with Senator Chafee's staff, Representative Garcia's staff, and others over the last couple of years on this legislation and I wanted to say that in general, we support the legislation. However, we do have some very severe reservations about specific points, which I will come to in a minute.

We feel that this is most unfortunate because there need not be conflict on this bill between preservation and the job-creating objectives. Preservation has changed dramatically in the last 10 years from being concerned with single landmarks to being concerned with the economic realities of our communities. Certainly in Providence, you have seen that, Senator Chafee, and throughout Louisiana we have become a mainstream part of economic development.

The National Trust has fostered this through many new programs: The Inner City Ventures Fund fostering inner city low income housing in historic districts; our industrial reuse program in our Northeast Regional Office looking at the reuse of mill buildings in cooperation with many companies, and through many other initiatives.

So we feel that it is unfortunate that this legislation, as now drafted, may set the stage for unnecessary conflict at the local level.

There is also a past history of problems between HUD and programs of HUD and historic preservation. Secretary Pierce used a very unfortunate metaphor, I think, in stating that he wanted to level the playing field. We don't particularly think the playing field needs to be leveled. We think there are a lot of historic resources that can be used in this program.

UDAG began with enormous controversy with preservation. There were cookie-cutter franchised hotels planted all over this country in the first couple of years of UDAG, and finally we got the process improved through cooperation with HUD and now it is a very productive program for using historic resources.

Urban renewal leveled 20,000 acres of historic and older buildings, and of those acres, many of them are still standing vacant today, in spite of promises that buildings would go on them the next week or the next year.

Senator CHAFEE. Mr. Ainslie, we are not out to level things. What would you suggest? Give us your specifics and how you think we ought to remedy this.

Mr. AINSLIE. All right, let me move to those four specific recommendations.

As this committee well knows, the 25-percent investment tax credit that has already been passed is a major incentive and it should be used as part of the enterprise zone concept. The legislation discourages it in a number of ways.

First of all, there is no mention, nor requirement to conduct a historic resources survey when an area is designated. We feel that should be done. In many areas it can be done very quickly, and it should be done so that the 25 percent tax credit for rehabilitated buildings can be made part of this program. So first of all, a survey should be done as part of the application process.

Second, we feel that the waiver of the Environmental Policy Act and Historic Preservation Act are totally inappropriate. This is done in a very clever way, which says that designation of an enterprise zone area is not a Federal undertaking. Well, we find that a bit ludicrous to say that stating that Federal tax incentives and other priorities will apply is not a Federal undertaking. This clearly is Federal intervention and it should be subject to the other protections that already are in existence for both environmental and historic preservation concerns.

Unfortunately, if that waiver goes through, it is going to achieve exactly the opposite result. We are going to have delays, conflict at the local level, and problems that result from that waiver.

Third, we think that among the already listed Federal agencies that must be consulted by the Secretary of HUD, the Advisory Council on Historic Preservation should be added to that list of six or seven agencies, so that again, problems can be avoided and/or mitigated.

Finally, we think that in the encouragement of the relaxation or waiver of local regulations, it should be made clear that historic preservation ordinances are not encouraged to be waived. Again we may be threatening the historic resources that absolutely fill many of these inner city communities that are going to be targeted for these incentives.

So those are our four specific recommendations. We feel very strongly that they would improve this bill enormously, and in fact, expedite the designation and the initiation of programs in the enterprise zones.

[The statement of Mr. Ainslie follows:]

TESTIMONY OF MICHAEL L. AINSLIE
PRESIDENT OF THE NATIONAL TRUST FOR HISTORIC PRESERVATION
CONCERNING S. 863, THE ENTERPRISE ZONE EMPLOYMENT AND DEVELOPMENT ACT OF 1983
BEFORE THE SENATE COMMITTEE ON FINANCE

April 22, 1983

Mr. Chairman and Members of the Committee, I am Michael L. Ainslie, President of the National Trust for Historic Preservation. I am pleased to be able to appear before you today to share with you our views on S. 863, the Enterprise Zone Employment and Development Act of 1983.

As you know Mr. Chairman, the National Trust is a private nonprofit membership organization chartered by Congress to lead the nation's private sector historic preservation movement. We have followed with great interest the evolution of the enterprise zone legislation in this Congress and the last.

In general, the National Trust supports the concept of enterprise zones. There need be no conflict between the zone approach and historic preservation. In fact, we believe that historic resources will be a major asset to any designated zone area.

We believe, however, that S. 863 as drafted misses the opportunity to achieve the maximum advantage of historic resources for enterprise zones. In addition, we feel that S. 863 could have unintended, unnecessary harmful effects on historic resources located within enterprise zones. These effects must be avoided.

Past Errors

The preservation community has approached the concept of enterprise zones with great caution. We carry with us vivid memories of other new programs administered by the Department of Housing and Urban Development. These were advertised as great solutions to our urban ills, but were often ineffective and unnecessarily destructive to our nation's historic neighborhoods and downtowns.

The Urban Renewal program leveled great sections of our cities, destroying precious elements of our heritage that cannot be recreated. The Urban Development Action Grant program, in its early years, too often sacrificed historic resources instead of building upon them for a brighter economic future. That program has largely come around to the view that old isn't necessarily bad and that preservation holds great promise for achieving urban development goals. But that change took much time, and the federal bulldozer took a great toll.

Preservation and Economic Revitalization

We are also cautious about the concept of enterprise zones because we know well, and care deeply about, the communities that zones are intended to aid. Local preservationists and the National Trust are working in these depressed urban and rural areas to realize the potential of historic preservation for community residents. In cities and towns throughout our nation, preservation projects are creating jobs, building housing opportunities, increasing tourism and generating a renewed feeling of civic pride.

The areas that are likely candidates for zone designation often are the same areas that contain valuable historic resources. Fortunately, in many cases, many historic buildings and structures were saved from the wrecking ball because they were located in depressed areas that failed to attract new construction and development in the '60s and '70s. Today, these areas can draw on their historic past to create economic opportunity for the future.

The National Trust, through our National Main Street Center, our Inner-City Ventures Fund, our Rural Conservation Project and our Industrial Re-use Project is demonstrating the benefits of preservation in many enterprise zone eligible areas. In just two years, our National Main Street Center has fostered the creation of 340 businesses along the 29 historic main streets in which we have worked. Since 1981, our Inner-City Ventures Fund has helped create 655 housing units, 175,000 square feet of industrial space and 30 commercial locations by working with 19 neighborhood organizations in low and moderate income, often minority, neighborhoods. In the South Bronx, often cited as a prime enterprise zone candidate, the Fund has worked in the Longwood Historic District to convert burned-out brownstones into low-income housing. The work is being done by community residents for community residents. In the Northeast, our Industrial Re-use Project is helping to match industrial needs with the many available underutilized historic mills of the region. We are working with communities that have such mills to develop them for new businesses. Our programs, and the efforts of thousands of preservationists throughout the nation, give us insights into the impact of the pending enterprise zone legislation.

Effectiveness of Targeted Tax Incentives

Lastly, Mr. Chairman, we bring to the Committee our insights into the workings of targeted tax incentives. The historic rehabilitation tax credit, passed by Congress in 1981 with your leadership, have proven that targeted tax incentives, where sufficiently large, can direct private investment to specific areas. The incentives are one of only a few development incentives in the Internal Revenue Code that are geographically targeted. Investors in historic buildings within designated historic districts are eligible for a 25% investment credit for certified rehabilitation expenditures. In its short period of existence, this incentive has proven to be a powerful tool to achieve the complementary goals of revitalization and historic preservation. In 1982 alone, more than one billion dollars in projected historic rehabilitation expenditures were certified by the Department of the Interior.

The incentives are creating both commercial and residential opportunities. They are helping foster a better environment for those who work and live within historic districts. The tax incentives are helping investors overcome the problem of equity capital for rehabilitation investment in "marginal" neighborhoods. This success bodes well for the enterprise zone concept, which also targets tax incentives to chosen geographic areas. To the extent that the boundries of historic areas overlap with enterprise zones, the combined incentives of the 25% preservation credit and the 10% zone rehabilitation credit will work together to generate even more investment.

Preservation and Enterprise Zones

Historic resources will be important in making enterprise zones work. The ability to utilize an existing stock of buildings and structures will lower the cost of capitalizing new business. Small, historic structures can serve as incubators for new business much as many new ideas were first put into production in the basement of an investor's home. Larger historic structures can be adaptively reused for businesses needing room to grow, with available inexpensive space for future expansion.

For example, Clinton, Massachusetts is an old New England mill town that, until a few years ago, was mired in a recession with an unemployment rate approaching 20%. Historic and older buildings have been the linchpins of Clinton's recovery. Six high technology firms have invested or will invest $60 million to rehabilitate mills into industrial space employing more than 2,000 workers and creating 101 units of housing for the elderly. As a result of this investment, the unemployment rate of Clinton has fallen to below 4%. Not all cities and towns can be Clintons, but preservation holds much promise for economic revitalization, and it can work in tandem with enterprise zones to utilize historic resources.

Recomendations

In order to gain the benefits of historic preservation for enterprise zones and prevent the needless destruction of historic landmarks, we urge this Committee to amend the legislation to:

(1) mandate an historic preservation survey of areas nominated for enterprise zone status,

(2) eliminate the waiver of the National Environmental Policy Act and other environmental laws such as the National Historic Preservation Act that is proposed for the designation process,

(3) include the President's Advisory Council on Historic Preservation as one of the agencies to be consulted prior to zone designation and,

(4) make clear that the relaxation or elimination of protective landmark and historic preservation ordinances is not an encouraged action to reduce legal regulatory burdens.

Historic Survey

S. 863 does not require or encourage an historic preservation survey in potential zone areas. As discussed above, one of the important resources of an area seeking enterprise zone status is that area's historic properties. A good zone application should identify these important assets.

In addition, in order to evaluate any potentially adverse impacts designation may have on an area's historic resources, one must first identify those resources. Once identified, plans may be developed to avoid or mitigate potential harm. Examples would be local enactment of a protective ordinance or acquisition of an easement on a historic property in order to protect it during redevelopment for business location.

A requirement that all potential zones be inventoried would be neither burdensome nor time-consuming. Many potential enterprise zone areas are already inventoried. For these areas, a review and an update of the survey would be a minor requirement. For areas not yet surveyed, the State Historic Preservation Officer, in conjunction with the local government, could quickly perform or sponsor a survey. A survey involves the actual inspection of the area to identify potentially historic resources and subsequent research to verify and document the historic or cultural significance of districts and individual buildings, structures, sites, and objects. Consequently, the legislation should be amended to require an historic resources inventory as part of the zone application process.

Waiver of Environmental Reviews

We strongly object to Section 104(a)(c) of the bill that would waive application of the National Environmental Policy Act (NEPA) and "other provisions of federal law relating to the protection of the environment" to the zone designation process. We urge its deletion.

NEPA protects historic resources by mandating the careful evaluation of alternatives to actions that may harm the cultural environment. Eliminating this analysis of alternatives at the time of designation could lead to the needless loss of historic landmarks.

This provision could also be interpreted to deny application of Section 106 of the National Historic Preservation Act to the zone designation process. This interpretation would be harmful to historic properties located within zone areas by eliminating the involvement of the Advisory Council on Historic Preservation in zone designation and by removing from HUD the requirement to "take into account" the effect of designation on historic resources.

Application of Section 106 and its implementing procedures would guarantee the Council a formal opportunity to comment on the proposed designation and allow it the opportunity to negotiate a Memorandum of Agreement with HUD, the appropriate State Historic Preservation Officer and locality, concerning methods to avoid or mitigate harm to historic resources if an area is designated as an enterprise zone. Application of Section 106 to the designation process is critical because the designation process may be the only federal action that will take place under the enterprise zone program that would be subject to Section 106 review. All subsequent federal action in a zone may be limited to tax relief, which is not now subject to Section 106.

We believe that designation is the proper and most effective time for review. At that time, the Council can apply its expertise to the entire proposed zone area and avoid the potential of later controversy over specific actions within the zone. This controversy and litigation can delay investment and hurt the chances of zone success.

Council review under Section 106 need not be cumbersome nor delay designation. HUD could establish a Programmatic Memorandum of Agreement with the Council to specify expedited procedures for consideration of zone applications. The Urban Development Action Grant program procedures might be looked to as a model for expedited historic surveys and Council comment.

Participation of Advisory Council on Historic Preservation

As currently drafted, Section 101(a), "Designation," does not specify the Advisory Council on Historic Preservation as one of the agencies with which the Secretary of Housing and Urban Development must consult prior to designating an area as an enterprise zone. The Council is the Congressionally created advisory body on matters relating to preservation and, specifically, the impact of government programs on historic resources. Consequently, the Council is in an excellent position to aid the Secretary of Housing and Urban Development in evaluating designation proposals to utilize historic resources for economic development.

The Council is also best able to evaluate whether a particular area's designation, or a particular zone's boundaries, are inconsistent with the interests of historic preservation. Thus, we believe that the legislation should be amended to include the Advisory Council on Historic Preservation among the consulting agencies in the zone designation process.

Local Historic Preservation Laws

The proposed Section 7871(d)(2) of the bill would require areas to submit a "Course of Action" as part of their application for zone designation. One of the categories of suggested strategies is "actions to reduce, simplify, or streamline governmental requirements applying within the enterprise zone,..." We believe that this provision could have the effect of encouraging local governments to abandon, modify or avoid historic preservation ordinances to the detriment of historic resources.

Such protections, where lacking a vocal or powerful constituency, could be seen by local governments as good candidates for waiver in order to curry favor with HUD in the competition for designation. In contrast to zoning regulations that separate and restrict the use of property, landmark ordinances do not discourage business development. Instead, they protect a building's historic character while allowing contemporary, productive uses. Significantly, both the Internal Revenue Code's provisions for certifying local historic preservation ordinances and districts, and the provisions for certification of local governments under the National Historic Preservation Act, encourage the enactment of such local laws. Their abandonment would do little to further the chances of zone success and could even be counterproductive if valuable resources are wasted through demolition. To avoid this consequence and to be consistent with existing federal law, the legislation should be amended to discourage or prohibit the relaxation of historic preservation protections.

With these changes, we feel that enterprise zones and historic preservation can be partners in economic recovery. We look forward to working with the Committee in the days ahead to implement these changes so that we can proceed together to make enterprise zones a success in our nation's older and historic areas.

Senator **Chafee**. Well Mr. Ainslie, as you know, I have been a long-time supporter of historic preservation. I certainly don't want to be a participant in any effort that is going to result in leveling of these historic buildings and go contrary to the things that both you and I believe in. So we will work with you some more and see if we can't straighten these matters out.

It is important that we make a distinction between the application and the final approval, or what comes forward from the Secretary. For example, the Environmental Protection Act can be waived in the application. That doesn't mean that in the execution it can be waived.

The problem we have here, as you know, is that many of these cities are very, very poor cities. If we levy expensive requirements on them in the preparation of their application, we may be forestalling them from coming into the process. Whereas once they are in, then certain requirements can be levied on them. Then they know that they have it and they can proceed in that way and they may even get some assistance from HUD.

Also, you point out that instead of maybe having a mammoth survey, just have the State historic preservation officer do something. That would be helpful. That is a good suggestion.

Mr. **Ainslie**. We have met with HUD and we would work very closely to get that done very quickly, and we think it could be. We realize that we don't want to discourage communities, and we think that it could be done perhaps only with the finalists or only after an area has been designated.

Senator **Chafee**. OK. So therefore you wouldn't levy the requirement on the application or preapplication.

Mr. **Ainslie**. Not on the preapplication, correct.

Senator **Chafee**. OK. Fine. Thanks a lot, Mr. Ainslie. I am very conscious of this and will make sure that we talk with you and see if we can't satisfy your concerns as we move ahead.

OK. Mr. Zdenek.

STATEMENT OF ROBERT ZDENEK, PRESIDENT, NATIONAL CONGRESS FOR COMMUNITY ECONOMIC DEVELOPMENT, WASHINGTON, D.C.

Mr. **Zdenek**. Mr. Chairman, I want to thank you for giving me the opportunity to testify before the committee to present the views of both the National Congress for Community Economic Development and the National Neighborhood Coalition on the subject of enterprise zones.

I am president of NCCED, which is a national membership association of community-based economic development organizations, primarily community development corporations. I also serve as the chairperson of the economic development task force of the National Neighborhood Coalition, a nonprofit membership association made up of more than 50 national and regional organizations working with neighborhood groups.

I am going to get basically to the recommendations.

Basically we feel that there are four critical ingredients in the success of any enterprise zone. One is availability and cost of capital. Two is management and skills of workforce. Three is technical assistance. Four is ownership and control of certain resources by area residents.

Senator **Chafee**. You will have to explain what technical assistance means.

Mr. **Zdenek**. I will get to that.

Some of the suggestions I will recommend are included in S. 634, the Community Assistance and Revitalization Act of 1983.

The tax incentive that will most significantly address the availability and cost of capital is the expensing provision. The expensing provision will provide purchasers of stock or debentures of qualifying firms in enterprise zone areas an immediate ordinary loss deduction in the amount of their investment. Eligible firms would be those with a net worth of no more than $10 million, must receive at least half of their revenues from other than passive sources.

The advantage is that individuals and/or organizations would be able to get immediate tax credits for investing in zone firms, thus creating an incentive to invest. This is by far the most appropriate tax credit for enhancing business formation in distressed areas, a major goal of the enterprise zone legislation.

Senator **Chafee**. Well, we will consider that. You heard the Secretary talk about expensing. I suppose his concern about it just being a storage place would be met by your requirement that no more than 50 percent be in passive sources.

Mr. **Zdenek**. We would also like to suggest that the Senate Finance Committee consider the rollover tax incentive, as opposed to eliminating capital gains tax in enterprise zones. This is because of rollover of gain on the sale of property and/or business in an enterprise zone will require that the money is reinvested in firms in the zone.

This will create a greater multiplier effect in enterprise zone areas, as well as discouraging speculation, since investors and/or firms will have to pay taxes once they do not invest in an eligible firm in enterprise zone areas.

Just as we are nervous about excessive speculation, we are also concerned about businesses relocating from one distressed community to another distressed community which is designated as an enterprise zone. We urge the Senate Finance Committee to incorporate a statute that would not allow firms that move within a 12-month period from a distressed community to an enterprise zone area to be an eligible business in the zone.

This type of displacement is a zero sum activity, benefiting one community at the expense of another.

The bottom line in establishing any enterprise zone is to create job opportunities for both unemployed and underemployed individuals. The inclusion of a targeted jobs tax credit is at the heart of the concept, since it will provide a strong enough credit for an employer to hire unemployed individuals.

Instead of having a 4-year targeted jobs tax credit, we suggest a deeper 2-year tax credit of up to 75 percent the first year, not to exceed $6,000 and 50 percent the second year, not to exceed $6,000. The credit needs to be a significant incentive to hire local residents. But once an individual has worked for at least 2 years, they have gained stable employment. We question the need for the Government to continually subsidize employers once an employee has a stable job.

One of the pressing needs that both small businesses and distressed communities face is the need for technical assistance. S. 634 has a provision for the establishment of an entrepreneurial development center to be financed by investment tax credits not to exceed $750,000. These entrepreneurial development centers will provide management, marketing, financing, taxation, job training, rental space and other types of assistance to small and minority businesses in the zone.

Mr. Chairman, that is what I was referring to earlier. It will be a private entity operated on a for-profit basis and allowed to charge reasonable fees.

Senator **Chafee**. OK. You have to wind up now, Mr. Zdenek.

Mr. **Zdenek**. OK. One other that I want to focus on is the Neighborhood Assistance Act, which is a State tax credit program in nine States, and we encourage the Finance Committee to incorporate that into the enterprise zone legislation. The Internal Revenue Code would be amended to permit Federal tax credits of up to $250,000 per zone for corporations and individuals that make contributions to nonprofit organizations in enterprise zones that provides services and activities.

Lastly, we encourage the committee to look at the role of community-based development organizations and to take a flexible approach. There are essentially four major mechanisms, which I will just list. One is existing community-based development organizations. Two is the neighborhood enterprise association, which has been talked about in the House and Senate before. Third are employee stock ownership plans. Fourth are general stock ownership corporations or GSOC, and these are also included in S. 634 and we strongly encourage the committee to look at including some of these into the Enterprise Zone bill that you ultimately pass.

[The statement of Mr. Zdenek follows:]

TESTIMONY

Submitted By

ROBERT ZDENEK
President
NATIONAL CONGRESS FOR COMMUNITY ECONOMIC DEVELOPMENT

Chairperson, Economic Development Task Force
NATIONAL NEIGHBORHOOD COALITION

Before The

SENATE FINANCE COMMITTEE

THE HONORABLE JOHN CHAFFEE (R-RI)
Chairman

April 22, 1983

Mr. Chairman, I want to thank you for having the opportunity to testify before the Subcommittee to present the views of both the National Congress for Community Economic Development (NCCED) and the National Neighborhood Coalition on the subject of Enterprise Zones. I am President of NCCED, which is a national membership association of community-based economic development organizations, primarily community development corporations (CDCs). I also serve as the Chairperson of the Economic Development Task Force of the National Neighborhood Coalition, a non-profit membership association made up of more than 50 national and regional organizations which work with neighborhood groups.

As the Subcommittee has heard repeatedly, enterprise zones must not be viewed as a substitute for a comprehensive urban policy. Enterprise zones must be viewed as but one of a set of tools for economic revitalization that are appropriate in some economic development situations. There is a whole arsenal of federal, state, local, and private tools that can be utilized to revitalize distressed communities. Those localities and communities which have undertaken successful economic development efforts, such as Baltimore, have harnessed several different public and private resources toward a development project. Several of the leading corporations and financial intermediaries that the Reagan Administration has touted for their work in economic development, such as Control Data, the Rouse Company, and the Local Initiative Support Corporation (LISC) place a great importance upon utilizing public resources such as EDA, UDAG, CETA, etc. to broker the participation of private corporations in undertaking economic development activities.

The notion of attempting to separate the enterprise zone debate from other public policy debates in economic development is dangerous for several major reasons. First, the encapsulation of enterprise zones from other development policies will lead to greater chaos in development policy and direction, at a time the U.S. desperately needs a more coherent development policy.

Isolating enterprise zones or for that matter other tax policy incentives from other development tools will have the effect of emphasizing the limitations of the enterprise zone concept as opposed to enhancing the strengths of the zone concept.

There are obvious limitations to a concept predicated upon providing tax credits and deductions to businesses and individuals. A major limitation to the concept is that many new and/or existing small businesses have negligible tax liabilities because they are generating insufficient revenue. Numerous studies and practical experience have also shown that tax concessions are a relatively insignificant factor in affecting the location of new firms and branch plants. The Council of State Planning Agencies, an affiliate of the National Governors Association, published a major study on Taxes and Crowth: Business Incentives and Economic Development. In a 1979 survey of over several thousand new firms on the importance of factors affecting intrastate location decisions, CSPA found that only 14.4 percent of the businesses rated state business tax structures as a deciding positive influence as compared to 30.0 percent for availability of capital and 50.0 percent for access to growing markets. CSPA also found that for branch plants state business tax structure was rated as a significant factor by only 35.7 percent of the respondents. These examples point out that the impact of taxes on business formation and location is at best marginal. Federal tax credits for employers and employees and the reduction in capital gains taxes for zone eligible firms may help provide financial inducements for firms in the zone area to expand. However, these tax incentives must be strengthened with state, local, and private tax, as well as direct financial and technical incentives such as risk venture capital pool. Our major concern on state and local incentives is that states and local governments which have severe economic problems are those entities which have a high number of areas of economic distress and may not be able to provide strong enough incentives to receive enterprise zone designation. Even if the states and localities are awarded a federal enterprise zone status, their incentives might not be strong enough to make the zones succeed.

Based on our experience in economically revitalizing distressed communities, there are four critical ingredients that determine the success of any activity. They are:

1. availability and cost of capital
2. management and skills of workforce
3. technical assistance
4. ownership and control of certain resources by area residents

Even though the enterprise zone concept is predicated primarily on taxes, it must be measured on the above mentioned ingredients to stimulate economic development in distressed communities.

The remainder of my testimony will focus on how tax and other incentives can strengthen the four areas previously mentioned. Some of the suggestions that I will recommend are included in S.634, the Community Assistance and Revitalization Act of 1983.

The tax incentives that will most significantly address the availability and cost of capital is the expensing provision. The expensing provision will provide purchasers of stock or debentures of qualifying firms in enterprise zone areas an immediate "ordinary loss" deduction in the amount of their investment. Eligible firms would be those with a net worth of no more than $10 million which receive at least half of their revenue from other than passive sources (rents, royalties, interest, and the like). The advantage is that individuals and/or organizations would be able to get immediate tax credits for investing in zone firms, thus creating an incentive to invest. This is by far the most appropriate tax credit for enhancing business formation in distressed areas, a major goal of the enterprise zone legislation.

We would also like to suggest that the Senate Finance Committee consider the "rollover" tax incentive as opposed to eliminating capital gains tax in enterprise zones. This is because a rollover of gain on the sale of property and/or business in an enterprise zone will require that the money is re-invested in firms in the zone. This will create a greater multiplier effect in enterprise zone areas as well as discouraging speculation, since investors and/or firms will have to pay taxes once they do not invest in eligible firms in enterprise zone areas. The elimination of capital gains does not provide such a strong disincentive to move funds out of enterprise zone areas.

Just as we are nervous about excessive speculation, we are also concerned about businesses relocating from one distressed community to another distressed community which is designated as an enterprise zone. We urge the Senate Finance Committee to incorporate a statute that would not allow firms that move within a twelve-month period from a distressed community to an enterprise zone area to be an "eligible business" in the zone. This type of displacement is a "zero-sum" activity benefiting one community at the expense of another.

The "bottom-line" in establishing any enterprise zone is to create job opportunities for both unemployed and underemployed individuals. The inclusion of a Targeted Jobs Tax Credit (TJTC) is at the heart of the concept, since it will provide a strong enough credit for an employer to hire unemployed individuals. Instead of having a four-year Targeted Jobs Tax Credit, we suggest a deeper two years tax credit of up to 75 percent the first not to exceed $6,000, and 50 percent the second year -- not to exceed $6,000. The credit needs to be a significant incentive to hire local residents, but once an individual has worked for at least two years they have gained stable employment. We question the need for the government to continually subsidize employers once an employee has a stable job.

One of the pressing needs that both small businesses and distressed communities face is the need for technical assistance. S.634 has a provision for the establishment of an Entrepreneurial Development Center (EDC) to be financed by investment tax credits not to exceed $750,000. These Entrepreneurial Development Centers will provide management, marketing, financing, taxation, job training, rental space, and other types of assistance to small and minority businesses in the zone. They will be a private entity operated on a for-profit and allowed to charge reasonable fees. EDCs should also work closely with community-based organizations and contract with community-based organizations that have a demonstrated capacity to deliver a technical assistance such as job training or packaging business deals.

Community-based organizations can play a significant role in providing services and technical assistance to businesses in the enterprise zone. The reduction in federal funding has affected the capacity of community-based organizations to provide these services. To strengthen the capacity of these organizations, we recommend the inclusion of the Neighborhood Assistance Act, a program in nine states that provides tax credits to corporations and individuals that make contributions to community improvement projects. NAA is a tested state tax program that has influenced the decisions of numerous corporations to become more involved in economic revitalization. We suggest the following amendment language:

> "The Internal Revenue Code would be amended to permit federal tax credits of up to $250,000 per zone, for corporations and individuals that make contributions to non-profit organizations in enterprise zones that provide services and activities designated to enhance the overall goals of the enterprise zones."

This will increase the involvement of the corporate sector in enterprise zones and provide private funding for needed economic development services. States and local government that are economically hard pressed will not be able to finance these services, as implied by the Reagan Administration. EDCs and the NAA should be viewed carefully by the Senate Finance Committee.

Community participation and ownership of certain resources is the last major ingredient in an enterprise zone. The Reagan Administration and leading Congressional components of the enterprise zone all agree that residents must have a significant role in the implementation of the enterprise zone. However, there are disagreements over what types of community institutions and structures need to be development in enterprise zones. Since each community is different, we feel the legislation should be flexible in recognizing community-based organizations as long as they have widespread representation among the local community. Four of the major types of organizations that have been mentioned in various enterprise zone bills are:

1. existing community-based development organizations. These organizations exist in numerous low-income commmunities and are often referred to as community development corporations (CDCs). CDC activities range from financing small businesses to packaging business deals to linking job training and placement services. Naturally, it makes sense for enterprise zone authorities to utilize these organizations that have proven track record.

2. neighborhood enterprise associations. They would be composed of a majority of property owners in a several block radius. Neighborhood enterprised associations would perform public services and carry out neighborhood self-help projects. In turn, these associations would receive surplus public property from and service contracts from local governments. Neighborhood enterprise associations should not be established where there are other viable

community-based development organizations that are or could provide the same services, since it would be a duplication of effort.

3. Employee Stock Ownership Plans. S.634 encourages the expansion of employee stock ownership plans (ESOPs) among firms in enterprise zones. ESOPs provide an opportunity for employees, some of whom will be enterprise zone residents, to share in the benefits of their firms through owning shares. The Journal of Corporation Law recently reported that the average annual productivity growth rate of ESOP companies was 1.52 percent higher than comparable non-ESOP firms. The tax incentives for ESOPs in S.634, such as treating contributions to ESOPs as charitable contributions, should be incorporated into any final enterprise zone bill.

4. General Stock Ownership Corporation. Another innovative mechanism that is proposed in S.634 is the General Stock Ownership Corporation (GSOC). GSOCs are resident-owned corporations that will assure the community's active guidance of their redevelopment and the community's share of its resulting economic benefits. Each adult resident will be given one share and the GSOC board of directors will be composed of area residents. GSOCs will engage in real estate development activities and other economic development activities. Contributions from individuals and firms to GSOCs will receive significant tax incentives such as the nonrecognition of half the gain from sale or exchange of property to a revitalization area GSOC.

In closing Mr. Chairman, the suggestions proposed by the National Congress for Community Economic Development (NCCED) and the National Neighborhood Coalition (NNC) will contribute toward the economic revitalization of distressed communities. These suggestions do not require large appropriations, but will enable the zones to have a more significant impact in benefiting low-income people. Once again, we thank you for the opportunity to testify before your committee.

Senator **Chafee**. Thank you very much for your thoughts.

Our problem is we just don't want to make this thing too complicated. I just worry if we branch out and add a host of other activities to it, then we may be risking the passage of the whole legislation.

But your points are helpful. You made some good suggestions and we certainly will review them.

Mr. Rachels.

STATEMENT OF WILLIAM E. RACHELS, CHAIRMAN, NORFOLK ENTERPRISE ZONE COORDINATING COMMITTEE, NORFOLK CHAMBER OF COMMERCE, NORFOLK, VA.

Mr. **Rachels**. Senator Chafee, we appreciate the opportunity to file on behalf of the Norfolk, Virginia Urban Enterprise Zone Coordinating Committee this statement. We call to the committee's attention that attached to that statement are three letters of endorsement of the urban enterprise zone concept. One is from Virginia Governor Charles Robb, another from Virginia Delegate Robert Washington, who guided the State legislation through in Virginia——

Senator **Chafee**. These are statements you have?

Mr. **Rachels**. They are letters attached to the statement.

Senator **Chafee**. Oh, I see. We will make this part of the record. Why don't you summarize it?

Mr. **Rachels**. Yes, sir. The third letter there is from Norfolk Mayor Vincent Thomas in support of the enterprise zone concept.

The city of Norfolk enthusiastically supports the enterprise zone concept. We see it as a means for eliminating the blight situations and the creation of new job opportunities in distressed areas.

As the Senator referred earlier, billions of dollars have been spent in terms of urban renewal. The city of Norfolk itself has received in excess of $100 million in that effort.

That has been mainly the bulldozer effect, if you will. What we need now is the business incentive to come back in with nail and hammer and rebuild those areas. We feel that the urban enterprise zone concept can do that.

In such a zone, we would see a mixture of commercial, residential and industrial uses. Employees in these new businesses would often be residents of the area, and thus solve a number of those social and economic problems that are there.

The city of Norfolk has been involved in this effort since 1980, the summer of 1980. At that time, the chamber of commerce met with the City Council and it was decided that we would spearhead an effort. The coordinating committee was formed. The members of that committee included representatives from the city department and management staff, the Redevelopment Housing Authority, the Urban League of Tidewater, chamber staff and other business represetatives.

And particularly important there was the involvement of neighborhood groups. It was obvious from the outset that to make this concept go in a particular area, you had to have the support of the people who are most directly affected. Therefore, they have been included from the very start.

The Norfolk Chamber worked with Delegate Robert Washington for the passage of Virginia legislation, which is now in place.

Local applications will be received for Virginia designations during the summer of 1983. The act permits the Governor to designate up to six enterprise zones within the State for State implementation.

The coordinating committee then came back to the table, again to look within the Virginia legislation and the proposed federal legislation, where we could try to work out a zone. We first of course focussed upon a zone site. That was then determined.

Then we established certain local incentives, which we would like to call to the committee's attention, to give you a flavor for what is happening down at the local level in this regard. There is a list of some eight incentives that are set forth in the statement submitted to the committee and I would just like to briefly touch upon the key ones of those.

There will be a facilitator team which will be made up of various community leaders, business and neighborhood groups, in order to guide the implementation of this zone: The coordinating, facilitating and promoting of that zone. One of the major concerns that we have had——

Senator CHAFEE. Now this facilitator team was formed by the city of Norfolk?

Mr. RACHELS. It is formed by the coordinating committee, yes, sir, which is a combination of the city of Norfolk council, the business interests, the Redevelopment Housing Authority, the neighborhood——

Senator CHAFEE. And who pays them? Whose payroll are they on?

Mr. RACHELS. This is all gratuitous, all unpaid. These are volunteers.

Senator CHAFEE. I see.

Mr. RACHELS. Second, start-up capital was a major concern. We have had put together a group of the financial institution representatives who have come up with a plan under which it is contemplated that not only will conventional loans be made available for the redevelopment area, but also that there will be certain set-asides of industrial development bonds which will be available for this particular zone.

In addition, these financial institutions will be set up to assist the borrowers in processing loans and qualifying for them.

There will be a resource commitment, in terms of trying to use community development funds and other related funds, to match up with private enterprise development in the zone, and use those in a cohesive manner.

There will be a special effort for job training within the zone to hire the disadvantaged, in order to get some of the tax credits that are available through the Federal legislation that is now pending before this committee.

The enhancement of the public services is another feature, where it is under consideration to do some private contracting, where appropriate——

Senator CHAFEE. Now of course these are all ingredients that would go into the package for qualifying for a Federal zone.

Mr. RACHELS. Yes, sir.

Senator CHAFEE. It is interesting what you have done. All right, go ahead. Local zoning procedures?

Mr. RACHELS. Yes, sir. We hope to develop a system whereby the zoning procedure down there will be not as ironclad as it has been in the past, but rather, be able to use some variances in there to fit this kind of community together in one particular spot.

The permitting process would be streamlined, and in particular, to have someone designated to walk a prospective applicant through in order to get the zoning and other necessary matters through city hall and to streamline that process.

Senator CHAFEE. Now you have to wind up.

Mr. RACHELS. In sum, Senator, we are very much in support of Senate bill 863. We appreciate the committee's indulgence, and we look forward to passage.

[The statement of Mr. Rachels follows:]

STATEMENT
on
THE ENTERPRISE ZONE EMPLOYMENT AND DEVELOPMENT ACT OF 1983 (S.863)
for submission to the
SENATE COMMITTEE ON FINANCE
for the
NORFOLK, VIRGINIA URBAN ENTERPRISE ZONE COORDINATING COMMITTEE
by
William E. Rachels, Jr.*
April 22, 1983

The City of Norfolk enthusiastically supports the urban enterprise zone concept. It is not seen as a substitute for existing community development programs, but rather as a valuable expansion of these programs. The objectives of our city in managing redevelopment programs can be met sooner and in a more complete way with the addition of these types of business and development incentives. It is a chance to let the private sector carry some of the burden of blight elimination and create new job opportunities in special inner city areas without the direct subsidies required by other development programs in the past.

The City of Norfolk has always been a leader and innovator in successfully using federal and state initiatives offered to assist central cities in revitalizing distressed portions of their older neighborhoods and central business districts. The City's earliest renewal efforts efficiently solved housing problems caused by the sudden influx of military personnel to this area following the outbreak of World War II. Thirty-five hundred low-income units were produced and managed by the local Housing Authority. Soon after the war effort, priority for military housing gave way to local concern over urban blight and clearing some of the worst deteriorated slum conditions in the nation. After a comprehensive study of blighted conditions in the city, the first redevelopment project in the United States was initiated in Norfolk in 1951 under the Housing Act of 1949. This was the beginning of the City's early downtown reconstruction efforts.

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*Chairman, Norfolk, Virginia Urban Enterprise Zone Coordinating Committee and Immediate Past President, Norfolk Chamber of Commerce.

In the years that followed, local participation in federal Conventional Urban Renewal, Model Cities, Neighborhood Development and Community Development Block Grant programs has resulted in the public expenditure of over $100 million in redevelopment activities throughout the city in targeted distressed areas.

Today, seventeen redevelopment projects, thirteen low income housing parks and seven conservation areas attest to the success of these government subsidy and grant programs. The enormous public expenditures for the acquisition of properties, the relocation of families and businesses, the clearance of blight, and the installation of public improvements have been matched by private investment in certain of these areas, especially the downtown business district. However, other areas have not experienced strong reinvestment. Many of the cleared areas of the 1950's remain that way today. Other blighted areas still exist much the same as they did twenty years ago.

A major need for pursuing the establishment of an enterprise zone in Norfolk reflects the failure of previous conventional government programs to assure the efficient reuse of land made available through the redevelopment process. We feel the enterprise zone concept could speed up the revitalization of many potential development sites by offering businesses tax incentives and easing regulations to businesses if they were to locate there.

Urban renewal alone has failed to bring back to the city the vitality and economic activity it once had. The proper business climate for private enterprise must be restored to accompany physical improvements. The special incentives of an enterprise zone are needed to alter adverse perceptions of businesspersons towards settling these areas. This is one reason why the enterprise zone idea has been so enthusiastically accepted in Norfolk.

Norfolk's attempts to rid itself of severely blighted residential and commercial properties have had negative consequences for the upgraded sections of the older inner city. The displacement of slum households into publicly subsidized units has ringed the downtown area with low-income, primarily minority households. Similarly, less expensive private housing made available to other disadvantaged households seems to be concentrated in the area surrounding downtown revitalization projects. This is the area in which Norfolk proposes to establish its enterprise zone. In such a zone, there would be a mixture of commercial, residential, and industrial uses. The employees would often reside in the zone. Such creation of jobs for the economically disadvantaged is an outstanding benefit of this program for the community.

The public sector can provide infrastructure support; however, there are increased operating costs which are necessarily associated with doing business in older, distressed areas. Crime and the threat of vandalism raise insurance and security costs. Employees are often reluctant to work in such areas, particularly after dark. Older structures are available, but require costly upgrading of interior systems. A proximate workforce with appropriate skill levels is often unavailable. All of these factors directly raise the costs of doing business in these distressed areas. These ongoing problems cannot be addressed simply by the infusion of public dollars.

To reverse the psychology of crime, active involvement of neighborhood residents is a must, as evidenced by the success of self-help block security programs. In addition, the public sector cannot directly underwrite the costs of day-to-day business operations. A program is required which effects reductions in certain cost centers to offset the other higher costs of doing business in distressed areas. By reducing the cost burdens of taxation and over-regulation, the enterprise zone concept serves to bring the total cost of doing business in such areas more in line with the costs incurred in newer, more affluent areas.

Funding availability for achieving renewal goals has become very limited in recent times. Until 1976, Norfolk's community development funding level was approximately $17 million annually. Over the past seven years, however, that entitlement has declined steadily to just over $6.5 million, while the program needs have remained constant if not greater. Public programs by themselves can no longer support the cost of maintaining the urban infrastructure and at the same time start new projects.

Without the funds to support continued large scale redevelopment efforts, Norfolk's strategy for achieving community improvement is becoming more and more based on the interlocking support of public assets and improvements to generate private development in a partnership for revitalization. Norfolk is anxious to be an innovative pioneer once again in an enterprise zone program that encourages private enterprise to participate in bringing depressed areas of our city back to economic and physical life.

EFFORTS TO DATE

The Norfolk Chamber of Commerce began Norfolk's enterprise zone effort in July of 1980. The advantages of a program of this sort were readily apparent to the Chamber staff and business volunteers. A meeting was called at the Chamber involving city officials, redevelopment and housing authority representatives and other concerned individuals to discuss the benefits an enterprise zone could offer Norfolk.

As congressional action on the legislation was monitored, it became apparent that to take advantage of federal incentives, state and local cooperation was mandatory. In October of 1981, the president of the Chamber of Commerce appeared before the Norfolk City Council requesting that Norfolk's city government commit the necessary resources to work with the Chamber as part of a vital effort to refine and develop a local incentive package, to develop and pursue state legislation, and to continue to monitor and support appropriate federal legislation.

Norfolk City Council gave its support to the Chamber, and the Urban Enterprise Zone Coordinating Committee was formed. Members of the committee included representatives from City department and management staff, the Norfolk Redevelopment & Housing Authority, the Urban League of Tidewater, Chamber staff and other representatives of the business community, and other concerned groups. Since Norfolk appeared to have several areas that could qualify as enterprise zones, neighborhood group representatives from those areas were also asked to serve on the committee. From the beginning of Norfolk's efforts, neighborhood group involvement was deemed crucial to a successful enterprise zone. The goals and the guidance of those living in the zone have been the cornerstone of all of our discussions.

In the fall of 1981, after meeting with the coordinating committee, General Assembly Delegate Robert Washington of Norfolk agreed to sponsor enterprise zone legislation in the 1982 Virginia General Assembly.

Delegate Washington, who chairs the House Labor and Commerce Committee and is a member of the Virginia Housing Study Commission, worked with the coordinating committee in drafting the state legislation. Committee representatives testified in hearings on the bill, and the Chamber's legislative staff worked with Delegate Washington as the bill moved through the General Assembly. The legislation passed with almost unanimous support in both houses, with total support from Governor Charles S. Robb.

With regard to the designation of zones, the Virginia program is a competitive one; while an area may meet the eligibility criteria, this does not guarantee its acceptance into the program. Further, although Virginia's incentives are available to businesses that exist or relocate in an enterprise zone, the business must meet the eligibility criteria outlined in Virginia's Urban Enterprise Zone Act.

The incentives package for Virginia's zone includes a public land auction for development purposes, a provision for local regulatory tax relief, and three tax concessions. These are: 1) a five year decreasing (80%, 60%, 40%, 20%, 20%) business income tax credit for qualified business firms; 2) an individual income tax credit for each partnership in proportion to income received from the partnership; 3) a five-year state sales tax exemption on items purchased for the conduct of business in the zone.

The public land auction is open only to those persons willing to develop public land which has not been designated for a particular use. The purpose of this incentive is to increase potential for development in state zones while reducing speculation.

The legislation does not address specific local implementation. This implementation gap allows flexibility and innovation, which is critical to the enterprise zone concept. Each locality is responsible for local incentives. Augmenting enterprise zone legislation are statutes such as the Neighborhood Assistance Act and a property tax abatement for rehabilitation, which were passed by recent sessions of the Virginia General Assembly.

The Virginia Department of Housing and Community Development will implement the State's Enterprise Zone Act. Its responsibilities are to establish zone eligibility criteria, to administer and enforce the accompanying regulations, to monitor and evaluate the Act, and to assist local units in zone operations.

Local applications will be made to the Virginia Department of Housing and Community Development in the summer of 1983. The application must include a description of the location of the proposed area and a general statement identifying proposed incentives. Application review, as stated in the Act, must be completed within 60 days of the application deadline. After review of the applications, the Secretary of Commerce and Resources within 30 days will recommend to the Governor those applications with the greatest potential. The Act authorizes the Governor to designate up to six enterprise zones statewide.

Once the state program was in place, the Norfolk Enterprise Zone Coordinating Committee of 30 individuals began working to develop a local incentives package. The first priority was the selection of the zone site. After drawing up a list of proposed zone selection criteria, it was determined that three neighborhoods in the heart of the city would qualify: Berkley, Church Street/Huntersville, and Park Place.

As work continued with the coordinating committee touring and examining data concerning these three areas in depth, it became apparent that each of them had unique opportunities to offer in commercial, industrial, and residential opportunities respectively which could best be utilized by a zone combining adjacent portions of the three neighborhoods.

The local goals of Norfolk's enterprise zone were developed and divided into four main categories: economic, social, physical and municipal. To achieve these goals, a potential local incentive package was shaped after studying the needs of the neighborhoods in the potential zone area. The following incentives are under development:

1. A facilitator team would be created to guide the implementation of the Norfolk enterprise zone program. Representation on the facilitator team would come from the public and private sector as well as civic organizations and other groups. Its range of responsibilities would include coordinating, facilitating and promoting Norfolk's enterprise zone.
2. One of the major concerns of Chamber representatives from their experience in business counseling has been the availability of start-up capital for small businesses wishing to locate within the zone. The Enterprise Zone Coordinating Committee feels that participation of small business will be a major factor in determining the success of the zone. Because neither the state legislation nor the federal legislation provides for this funding, a top priority has been to work with local financial institutions on this funding.

An important element of our local incentive package is an Urban Enterprize Zone Development Loan Fund. A committee of our local bank and thrift executives is presently working on this project, and although the amount and final features of the Fund have yet to be determined, it is comtemplated that each participating institution will agree to provide the Fund not only with conventional loans but also with some allocation of relatively scarce dollars for tax-exempt industrial development bonds at favorable loan rates. Our bankers committee will also be providing assistance in creating the mechanisms for helping prospective borrowers, especially small businesses, to prepare loan applications, financial projections, and market studies as well as the referral procedures for locating appropriate venture capital sources.

3. Business counseling would be coordinated by the facilitator team. The Chamber of Commerce would have the main responsibility, with support from other public and private organizations. This effort is designed to provide business counseling services without cost to the small business person who needs assistance but generally does not have access to it.

4. The city's programs of resource commitment would be continued in the zone area. Community development efforts in the zone would be continued or initiated. A portion of the zone's community development allocation would be used to establish a loan interest subsidy fund and an economic development fund, both of which could be tapped to support private development efforts. Funds could be made available by setting aside an annual allocation of capital improvement projects funds

to accomplish specific public improvement efforts in support of and in response to private development proposals. A high priority of the city's enterprise zone program would be job training that would aid in the hiring of the disadvantaged that reside both in the zone and in other sections of the city. The goal would be to provide the disadvantaged permanent skills from the enterprise zone program experience.

5. An enhancement of public services in the zone would be provided. This would include an increase of police and fire protection and include general environmental upgrading such as the removal of trash and the management of vacant lots. Also included is the investigation of the potential to contract private (preferably neighborhood) groups to provide certain of these services.
6. The feasibility of and need for more flexible zoning procedures in the enterprise zone are being investigated. Existing flexible procedures such as conditional zoning could provide the basis for this incentive.
7. The permitting process would be streamlined by having facilitator team members walk potential developers through the established permitting procedures. To achieve this goal, established permitting time tables would not necessarily be changed, but rather prospective developers would be taken through the process systematically to ensure that important deadlines are met.
8. The facilitator team will continue to work to identify and monitor changes in local and state tax structures which will provide incentives for enterprise zones.

S. 863

The Norfolk Enterprise Zone Coordinating Committee supports S.863. We are pleased that both Senators John W. Warner and Paul S. Trible are listed as co-sponsors on S.863, and that Representative G. William Whitehurst of Norfolk is one of the co-sponsors of H.R. 1955, similar legislation in the House of Representatives. Having been involved over the past three years with the basic enterprise zone concept and several different pieces of federal legislation, we feel that this bill offers a workable proposal upon which many of our efforts up to this point have been based.

State and local efforts are being successfully developed in Virginia; however, Virginia has always had a relatively favorable business climate. The reduction or elimination of the state and local tax and regulatory burden will help attract new business activity. The simultaneous reduction of the heavy federal tax and regulatory burden is essential to ensure the program's success.

We urge the members of this committee to support this legislative proposal which would allow free enterprise rather than subsidies to restore our cities.

ADDITIONAL INFORMATION

A. Letter of Endorsement from Virginia Governor Charles S. Robb

B. Letter of Endorsement from Virginia Delegate Robert E. Washington

C. Letter of Endorsement from Norfolk Mayor Vincent J. Thomas

D. The Virginia Urban Enterprise Zone Act

A

COMMONWEALTH of VIRGINIA
Office of the Governor
Richmond 23219

Charles S. Robb
Governor

April 18, 1983

The Honorable Robert Dole
United States Senate
141 Hart Building
Washington, D. C. 20510

Dear Senator Dole:

I am pleased that the City of Norfolk has been invited to testify before the Senate Finance Committee on the "Enterprise Zone Employment and Development Act of 1983." Since Norfolk was selected as the first city in the country to receive a redevelopment project under the U. S. Housing Act of 1949, it has been a leader in undertaking innovative approaches to the revitalization of inner-city areas. Much of the city's success can be attributed to the strong commitment of Norfolk's city government to work with the private sector.

Norfolk has also been a leader in Virginia's enterprise zone efforts. It had an enterprise zone task force in operation before the state law became effective. Norfolk's representative to the General Assembly sponsored the bill which led to Virginia's Urban Enterprise Zone Program. Norfolk also served on the committee of private sector and local government representatives who assisted in drafting Virginia's enterprise zone rules and regulations. Norfolk has supported and encouraged the state's efforts in every possible way, and I am sure its representatives will offer helpful suggestions in the development of the federal legislation.

Virginia was among the first states to enact enterprise zone legislation, and we hope there will soon be a federal enterprise zone statute. We believe there are significant advantages to be gained by having state and federal zones operating in conjunction with one another. Designation of a federal zone in Virginia would promote state-federal cooperation and increase the chance of success in achieving the objectives of this program.

The Honorable Robert Dole
Page Two
December 18, 1983

We enthusiastically support federal efforts to get this program underway.

Sincerely,

Chuck Robb

Charles S. Robb

CSR/jhw

cc: Mr. William Rachels, Jr., Chairman
Urban Enterprise Zone Coordinating Committee
Post Office Box 327
Norfolk, Virginia 23501-0327

B

COMMONWEALTH OF VIRGINIA
HOUSE OF DELEGATES
RICHMOND

ROBERT E. WASHINGTON
SUITE 710
142 W. YORK STREET
NORFOLK, VIRGINIA 23510

THIRTY-NINTH DISTRICT
NORFOLK

COMMITTEE ASSIGNMENTS:
LABOR AND COMMERCE
(CHAIRMAN)
ROADS AND INTERNAL NAVIGATION
APPROPRIATIONS

April 18, 1983

The Honorable Robert Dole
Chairman, Finance Committee
United States Senate

RE: Urban Enterprise Zone Legislation

Dear Senator Dole:

I am pleased to submit this statement in support of the testimony by representatives of the City of Norfolk, Virginia favoring the Federal Urban Enterprise Zone legislation.

As a member of the Virginia State Legislature, I sponsored the Virginia Urban Enterprise Zone Act, which was passed in 1981, with near unanimous support in both Houses of the General Assembly. Regulations are now being promulgated to implement the Act. We are extremely optimistic for chances of success in State designated zones. Substantial success over the long term, however is dependendt upon parallel Federal Action.

Virginia, like all other states, can provide incentives for economic development only within the framework of our state enacted tax policies and regulations. A greater measure of relief, and thus a greater incentive for development, potentially exists within the Federal tax structure and regulations. Accordingly, I urge your Committee and the Congress of the United States to join with the several states that have enacted Urban Enterprise Zone legislation and favorably consider the legislation before you.

Lastly, the City of Norfolk representatives before you, including Mr. William E. Rachels, Jr., and other associated with the Norfolk Chamber of Commerce, were in the forefront of the bi-partisan efforts that led to the passage of the Virginia Act. I am confidents that you will find their testimony supportive and instructive. Thank you for your consideration.

Very truly yours,

Robert E. Washington

REW/sh

C

City of Norfolk
Virginia

Office of the Mayor

April 18, 1983

The Honorable Robert Dole
Chairman
Senate Finance Committee
2213 Dirksen Senate Office Building
Washington, D. C. 20510

Dear Senator Dole:

It was with great pleasure that I learned the City of Norfolk had been asked to participate in the Senate Finance Committee hearings on the Urban Enterprise Zone legislation. Since word was first received many months ago that the Administration would pursue Enterprise Zones as its fundamental urban policy, Norfolk has conducted energetic and productive efforts in anticipation of the Federal program implementation.

I believe that the single most important factor of the Enterprise Zone concept is the emphasis on private sector leadership. Under the chairmanship of William E. Rachels, Jr., the Norfolk Urban Enterprise Zone Coordinating Committee has diligently laid the foundation and erected a structure necessary to ensure the smooth and successful creation of our Zone.

I would like you and the members of the Senate Finance Committee, indeed the Congress as a whole, to know that the Norfolk City Council has, from the beginning, endorsed not only the concept of Urban Enterprise Zones, but also the Federal Enterprise Zone legislation. We very much appreciate the support the legislation enjoyed in the Senate last session; we are confident that there is an even deeper commitment in the new Congress. Norfolk has pledged to make its Enterprise Zone work, but the Federal legislation is needed to assure its success.

Sincerely yours,

Vincent J. Thomas

Vincent J. Thomas
Mayor

1982 REGULAR SESSION

D

CHAPTER

An Act to amend the Code of Virginia by adding in Title 59.1 a chapter numbered 22, consisting of sections numbered 59.1-270 through 59.1-284. providing for the Urban Enterprise Zone Act.

[H 689]

Approved

Be it enacted by the General Assembly of Virginia:

1. That the Code of Virginia is amended by adding in Title 59.1 a chapter numbered 22, consisting of sections numbered 59.1-270 through 59.1-284, as follows:

CHAPTER 22.

URBAN ENTERPRISE ZONE ACT.

§ 59.1-270. Short title.–This chapter shall be known and may be cited as the "Urban Enterprise Zone Act."

§ 59.1-271. Definitions.–As used in this chapter:

"Business firm" means any business entity authorized to do business in the Commonwealth of Virginia and subject to the state income tax on net corporate rate income (§ 58-151.031 et seq.), or a public service company subject to a franchise or license tax on gross receipts, or a bank, mutual savings bank, savings and loan association, or a partnership or sole proprietorship.

"Department" means the Department of Housing and Community Development.

"Secretary" means the Secretary of Commerce and Resources.

"Urban Enterprise Zone" means an area declared by the Governor to be eligible for the benefits of the Urban Enterprise Zone Act.

§ 59.1-272. Statement of purpose.–It is hereby declared that the health, safety and welfare of the people of the Commonwealth of Virginia are dependent upon the continual encouragement, development, growth, and expansion of the private sector within the Commonwealth and that there are certain areas in the Commonwealth that need the particular attention of government to help attract private sector investment. Therefore, it is the purpose of the Urban Enterprise Zone Act to stimulate business and industrial growth in such areas which would result in neighborhood revitalization of such areas of the Commonwealth by means of regulatory flexibility and tax incentives.

§ 59.1-273. Administration.–The Department shall administer this chapter and shall have the following powers and duties:

1. To establish criteria for determining what areas qualify as Urban Enterprise Zones. Such criteria shall be the minimum required for implementation of the purpose of this Act;

2. To monitor the implementation and operation of this chapter;

3. To conduct a continuing evaluation program of Urban Enterprise Zones;

4. To assist cities and counties in obtaining the reduction of regulations within Urban Enterprise Zones;

5. To submit annual reports evaluating the effectiveness of the program and any recommendations for legislation to the Governor; and

6. To administer and enforce the rules and regulations promulgated by the Board of Housing and Community Development.

§ 59.1-274. Urban Enterprise Zone designation.–A. The governing body of any county or city may make written application to the Department to have an area or areas declared to be an Urban Enterprise Zone. Such application shall include a description of the location of the area or areas in question, and a general statement identifying proposed local incentives to complement the state and any federal incentives. Adjacent jurisdictions may file a joint application for an Urban Enterprise Zone lying in both jurisdictions.

B. The Governor shall approve upon the recommendation of the Secretary the designation of up to six areas as Urban Enterprise Zones for a period of twenty years. No more than four zones shall be designated during the first year after the effective date of this Act. Any such area shall consist of contiguous United States census tracts or block groups in accordance with the 1980 United States Census. Any such area shall also meet at least one of the following criteria: (i) twenty-five percent or more of the population of the area shall have incomes below eighty percent of the median income of the jurisdiction. or (ii) an unemployment rate 1.5 times the state average.

§ 59.1-275. Application review.– A. The Department shall review each application upon receipt and shall secure any additional information that the Department deems necessary for the purpose of determining whether the area described in the application qualifies to

be declared an Urban Enterprise Zone.

B. The Department shall complete review of the application within sixty days of the last date designated for receipt of an application. After review of the applications, the Department shall forward those applications qualifying for an Urban Enterprise Zone to the Secretary. The Secretary shall recommend to the Governor within thirty days those applications with the greatest potential for accomplishing the purpose of this Act . If an application is denied, the governing body shall be informed of that fact together with the reasons for the denial.

C. If any portion of an area designated as an Urban Enterprise Zone under this Act is included in an area designated as an Urban Enterprise Zone by an agency of the federal goverment, the area designated by this Act shall be enlarged to include the area designated by the federal agency.

§ 59.1-276. Sale of public land.–Upon designation of an area as an Urban Enterprise Zone, the Commonwealth and any units of local government that own any land within the Urban Enterprise Zone shall make available for sale all land within the Urban Enterprise Zone not designated or targeted for some public use with the condition that it be developed.

§ 59.1-277. Government assistance; prohibition.–There shall be no duplication of existing state tax incentives to qualified business firms which locate in an Urban Enterprise Zone.

§ 59.1-278. Rules and regulations.–Rules and regulations prescribing procedures effectuating the purpose of this Act shall be promulgated by the Board of Housing and Community Development in accordance with the Administrative Process Act.

§ 59.1-279. Eligibility.–A. Any business firm may be designated a "qualified business firm" for purposes of this chapter if:

1. It (i) begins the operation of a trade or business within an Urban Enterprise Zone, (ii) during the taxable year has at least fifty percent of the gross receipts of such business firm attributable to the active conduct of such trade or business within the Urban Enterprise Zone, and (iii) forty percent or more of the employees employed at the business firm's establishment or establishments located within the Urban Enterprise Zone meet the criteria set forth in paragraph (i) of subsection B of § 59.1-274 prior to employment; or

2. It (i) is actively engaged in the conduct of a trade or business in an area immediately prior to such an area being designated as an Urban Enterprise Zone, (ii) meets the requirements of (ii) of paragraph 1 of this section, and (iii) increases the average number of full-time employees employed at the business firm's establishment or establishments located within the Urban Enterprise Zone by at least ten percent over the preceding year's employment with no less than forty percent of such increase being employees meeting the criteria of paragraph (i) of subsection B of § 59.1-274 prior to employment.

B. After designation as an enterprise zone, each qualified business firm in such zone shall submit annually to the Department a statement requesting one or more of the tax incentives provided in this Act. Such a statement shall be accompanied by an approved form supplied by the Department and completed by an independent certified public accountant licensed by the Commonwealth which states that the business firm meets the definition of a "qualified business firm." A copy of the statement submitted by each business firm to the Department shall be forwarded to the governing body of the county or city in which the enterprise zone is located.

C. The form referred to in subsection B of this section, prepared by an independent certified public accountant licensed by the Commonwealth, shall be prima facie evidence of the eligibility of a business firm for the purposes of this section.

§ 59.1-280. State business income tax credit.–The Department shall certify annually to the Commissioner of the Department of Taxation, or in the case of public service companies to the Director of Public Service Taxation for the State Corporation Commission, the applicability of the tax credit provided herein for a qualified business firm against any tax due under Article 7.4 of Chapter 4 of Title 58 or against any income tax, franchise tax, gross receipts tax or shares tax due from a public service company, bank, bank and trust company, trust company, insurance company, other than a foreign fire or casualty insurance company, national bank, mutual savings bank, savings and loan association, partnership or sole proprietorship, in an amount equaling eighty percent of the tax due to the Commonwealth for the first tax year; sixty percent of the tax due the Commonwealth for the second tax year; forty percent of the tax due the Commonwealth for the third tax year; and twenty percent of the tax due the Commonwealth for the fourth and fifth tax years. Any tax credit not usable may not be applied to future tax years.

When a partnership is eligible for a tax credit under this section, each partner shall be *eligible for the tax credit provided for in this section on his individual income tax in proportion to the amount of income received by that partner from the partnership. Any qualified business firm having taxable income from business activity, both within and without the enterprise zone, shall allocate and apportion its taxable income attributable to the conduct of business in accordance with the procedures contained in §§ 58-151.034 through 58-151.050:3. Tax credits provided for in this section shall only apply to taxable income of a qualified business firm attributable to the conduct of business within the Urban Enterprise Zone.*

§ 59.1-281. State unemployment tax credit.–The Department shall certify annually to the Virginia Employment Commission the applicability of the tax credit for qualified business firms against Virginia's unemployment tax due on employees under Article 1 of Chapter 5 of Title 60.1 of the Code of Virginia in an amount equaling: eighty percent of the unemployment tax due to the Commonwealth for the first tax year; sixty percent of the unemployment tax due to the Commonwealth for the second tax year; forty percent of the unemployment tax due to the Commomwealth for the third tax year; and twenty percent of the unemployment tax due to the Commonwealth for the fourth and fifth tax years.

Tax credits provided for in this section shall only apply to the unemployment tax due on employees employed at the qualified business firm's establishment or establishments located within the Urban Enterprise Zone. Any tax credit not usable may not be applied to future tax years.

§ 59.1-282. State sales tax exemptions.–The Department shall certify annually to the Commissioner of Taxation that any qualified business firm is exempt from the payment of taxes for all items purchased for the conduct of its business located within the Urban Enterprise Zone, as required under Chapter 8.1 (§ 58-441.1 et seq.) of Title 58. Such exemption shall extend for a period not to exceed five years.

§ 59.1-283. Local incentives.–In making an application for designation as an Urban Enterprise Zone, the applying locality or localities may propose local tax incentives, including, but not limited to: (i) reduction of permit fees; (ii) reduction of user fees; and (iii) reduction of the business, professional, and occupational license tax. The extent and duration of such incentive ~~proposed in the locality's application~~ proposals shall conform to the requirements of the Constitution of Virginia and the Constitution of the United States. Such application may also contain proposals for regulatory flexibility, including, but not limited to: (i) special zoning districts; (ii) permit process reform; (iii) exemptions from local ordinances; and (iv) other public incentives proposed in the locality's application, which shall be binding upon the locality upon designation of the Urban Enterprise Zone.

§ 59.1-284. Termination of Urban Enterprise Zone.–Upon designation of an area as an Urban Enterprise Zone, the proposals for regulatory flexibility, tax incentives and other public incentives specified in this chapter shall be binding upon the local governing body to the extent and for the period of time specified in the application for zone designation. If the local governing body is unable or unwilling to provide the regulatory flexibility, tax incentives or other public incentives as proposed in the application for zone designation, the Urban Enterprise Zone shall terminate. Qualified business firms located in such Urban Enterprise Zone shall be eligible to receive the state tax incentives provided by this Act even though the zone designation has terminated. No business firm may become a qualified business firm after the date of zone termination. The governing body may amend its application with the approval of the Department, provided the governing body proposes an incentive equal to or superior to the unamended application.

2. That if any clause, sentence, paragraph, subdivision, section or part of this act shall be adjudged by any court of competent jurisdiction to be invalid, the judgment shall not affect, impair or invalidate the remainder thereof but shall be confined in its operation to the controversy in which the judgment shall have been rendered.

Senator CHAFEE. I think this is extremely interesting, particularly the reference to the facilitator teams.

One of the points you made that I think is so important concerns start-up capital. We have had a series of witnesses who have said that the real problem with these zones is the lack of venture capital they urge that we embark on some kind of a Federal provision that would make available this start-up capital.

I think that we have to look to the local forces, just as you have, for this start-up capital. To put in place some kind of a new Federal venture capital scheme is really not the way to proceed, although obviously the venture capital is an important factor to make the thing click. You have done that and that is very interesting.

Mr. Jackson, go ahead.

STATEMENT OF ROBERT JACKSON, PRESIDENT AND OWNER, TRIAX TUBE CO., BENTON HARBOR, MICH., ACCOMPANIED BY ELLIS MITCHELL, CITY MANAGER, AND WILLIAM LILLY, ECONOMIC DEVELOPMENT SPECIALIST

Mr. JACKSON. I am Bob Jackson. I am a businessman. Irrespective of everyone else you have talked to, I am the animal that has to put this thing to work.

I have brought with me today the city manager of Benton Harbor and the economic development specialist.

Senator CHAFEE. Gentlemen, why don't you come right up to the table?

Mr. JACKSON. Benton Harbor is located in southwest Michigan. It is a city of 15,000 people. We have 67 percent of our residents on public assistance. Thirty-five percent of the remainder is unemployed. Another way of stating it is that 79 percent is unemployed in Benton Harbor.

We have been adjudged by the department of commerce of the State of Michigan as the most needy economic development area in Michigan. Alexander Grant, a well-qualified certified public accountant, has judged Michigan as the most needy in the country.

Because we are in this unique position of being the leading candidate for an enterprise zone, we have worked for the last couple of years, both in the House, Senate, HUD, and the administration, on the development of good Federal legislation. We believe that this bill will help us rebuild our city more than all other proposed legislation combined. We strongly support this bill without significant changes.

We have taken this bill, developed it with our State legislators, our local government. We have incorporated a citizens council.

This document I have brought with me is a single copy of documents. If this bill that you had today was law, this is the application that we would provide to HUD. We have in here the endorsements not only from within the zone, but all the surrounding area. We answer the question of where the capital is coming from. We answer how the people will be in fact retrained and provided further employment. We show the compatibility of the State and Federal and local programs.

We need this program in Benton Harbor. We need it the way it is. We need it simple. We need it unbureaucratically controlled, easily administered. We feel you have obtained that and it is unique, this legislation. Preserve it. Pass it. We need it.

[The statement of Mr. Jackson follows:]

TESTIMONY
SENATE COMMITTEE ON ~~URBAN AFFAIRS~~ FINANCE
ENTERPRISE ZONE LEGISLATION
FRIDAY, APRIL 22, 1983
ROBERT G. JACKSON
CHAIRMAN, ENTERPRISE ZONE COMMITTEE
CITY OF BENTON HARBOR, MICHIGAN

GOOD MORNING MR. CHAIRMAN AND COMMITTEE MEMBERS. I APPRECIATE THIS OPPORTUNITY TO PROVIDE BRIEF COMMENTS ON THE ENTERPRISE ZONE LEGISLATION. I AM BOB JACKSON. I OWN AND OPERATE A 20-PERSON METAL FABRICATION BUSINESS IN BENTON HARBOR, MICHIGAN. I AM CHAIRMAN OF THE BENTON HARBOR ENTERPRISE ZONE COMMITTEE FOR THE CITY AND AM ACCOMPANIED BY MR. ELLIS MITCHELL, OUR CITY MANAGER, AND MR. WILLIAM LILLY, OUR ECONOMIC DEVELOPMENT SPECIALIST.

BENTON HARBOR IS LOCATED IN SOUTHWESTERN MICHIGAN. THIS CITY OF 15,000 HAS 67 PERCENT OF ITS RESIDENTS ON SOME FORM OF PUBLIC ASSISTANCE. THIRTY-FIVE (35) PERCENT OF THE REMAINING RESIDENTS ARE UNEMPLOYED. BUSINESS LOSSES AND URBAN DETERIORATION IS CONTINUING. BENTON HARBOR IS INORDINATELY QUALIFIED UNDER ALL CRITERIA OF THE LEGISLATION BEFORE THIS COMMITTEE. FOR BOTH 1981 AND 1982, THE MICHIGAN STATE GOVERNMENT HAS RATED BENTON HARBOR AS ITS CITY IN GREATEST NEED OF URBAN REVITALIZATION. FURTHERMORE, THE FOURTH STUDY OF GENERAL MANUFACTURING BUSINESS CLIMATES OF THE 48 CONTIGUOUS STATES OF AMERICA PUBLISHED BY ALEXANDER GRANT AND

Company, Certified Public Accountants, 1982, rates the State of Michigan as the state in greatest need of improvement to its business climate.

Because we are the leading small city candidate for Enterprise Zone designation, the Benton Harbor Enterprise Zone Committee has worked in detail with the House, Senate, HUD and the Administration for over two years to help develop good Federal legislation. We have worked equally in depth to formulate compatible Michigan State legislation. Benton Harbor has also developed and adopted specific incentives to make both State and Federal legislation compatible to our needs. All this has been done with enthusiastic surrounding community involvement to assure this program will be both successful for Benton Harbor and very beneficial to the surrounding area.

We believe that in order to rebuild our City from within, we must create a business climate where a normal business can make a reasonable profit over a long period of time with minimum government administrative involvement. We must also have opportunities to for and participation by our residents for holistic success. Of all anticipated legislation, we believe

THAT THIS SENATE BILL FOR ENTERPRISE ZONES, ALONG WITH OUR PROPOSED STATE LEGISLATION WILL HAVE BENEFICIAL IMPACT ON OUR CITY THAN ALL OTHER PROPOSED LEGISLATION COMBINED. IT WILL ALLOW US TO COMPETE WITH OTHER AREAS TO ATTRACT BUSINESS WITH LONG TERM INVESTMENTS. IT WILL ALLOW OUR EXISTING BUSINESSES TO GROW. ALSO THIS LEGISLATION ALONG WITH OUR STATE PROPOSALS WILL PROVIDE RESIDENTIAL CONSIDERATION SO THAT OUR ENTIRE CITY CAN BENEFIT.

THEREFORE, WE STRONGLY SUPPORT THIS SENATE BILL IN ITS PRESENT FORM WITHOUT SIGNIFICANT CHANGES. WE BELIEVE THAT THE INCENTIVES PROVIDED ARE SUFFICIENT TO HELP US REBUILD OUR CITY AND ARE NOT SO LARGE TO HAVE A NEGATIVE IMPACT ON OUR SURROUNDING AREA. OUR NEIGHBORING COMMUNITIES AND BUSINESS STRONGLY SUPPORT BENTON HARBOR IN ITS EFFORTS TO OBTAIN A WORKING ENTERPRISE ZONE AS PROPOSED IN THEIR SENATE BILL.

WHEN BENTON HARBOR RECEIVES ENTERPRISE ZONE DESIGNATION:

1. THE ENTIRE CITY LIMITS, WHICH CONTAINS APPROXIMATELY TWO (2) MILES SQUARE WITH A PROPER MIX OF INDUSTRIAL, COMMERCIAL, RESIDENTIAL AND RECREATIONAL AREAS SUITABLE FOR REVITALIZATION AND DEVELOPMENT, WILL BE INCLUDED.

2. The Federal government would give up two to three million dollars per year in lost revenues to finance its incentives compared to the 45 million and growing annual cost of maintaining our under-employed population.
3. Our zone would have a high probability of success due to extensive efforts of both Benton Harbor and the surrounding area.
4. Our zone would include small cities in the overall enterprise zone designation process.

Names, addresses and phone numbers are included in this testimony. We are anxious to follow this session with any discussion or information anyone wishes concerning the application of this legislation to Benton Harbor.

We need an enterprise zone.

Expedited passage of this Bill will be greatly appreciated by everyone in and around Benton Harbor.

Thank you.

Senator **Chafee**. Gentlemen, I think it is extremely important that you convey this message to your two Senators from Michigan, neither of whom are cosponsors of this legislation. We would like very much to have them as cosponsors and have their support. The fact that they are not cosponsors does not mean they are against it and I am not giving that implication. But they are Senators who we would like to have aboard.

Mr. **Jackson**. We do intend to see them today. One of the reasons that they are standing back is there is active creation of State legislation, on which we are testifying next week, in compatibility with this bill. We do feel that when the State has made its specific thoughts known, that Senators Levin and Riegle will in fact endorse this bill.

Senator **Chafee**. Yes; there is nothing mutually exclusive, of course, about the State legislation and this legislation. Most of the State legislation ties in with this.

Mr. **Jackson**. We feel that they must be compatible, neither overlapping or leaving holes. We have a program through the State for that.

Senator **Chafee**. Now, do the gentlemen with you wish to say anything?

Mr. **Jackson**. This is Ellis Mitchell, our city manager.

Senator **Chafee**. Yes, Mr. Mitchell?

Mr. **Mitchell**. Yes, sir. I would just like to say that the fact that we have our businessman as our spokesperson says to you and to others that we are working together in that copartnership effort as expressed by the Secretary.

We are prepared at the local level to enter into the enterprise zone. We are prepared to meet the state requirements when the state legislation is passed. We are ready for the enterprise zone. We need the enterprise zone. It is time for the city of Benton Harbor in particular and the southwest part of the State of Michigan to get back into the mainstream and about the business of revitalization.

Senator **Chafee**. And Mr. Lilly?

Mr. **Lilly**. The only thing I would say is that my professional experience for the most part has been working with businesses, trying to get them to utilize Federal incentives. For the past couple of years, the response that I have gotten from business is very positive.

I think that this particular legislation, the enterprise zone, no matter how it may come out, is probably the best legislation that has come about in quite some time that will be beneficial to business, that would cause them to perhaps reinvest money in the United States.

Senator **Chafee**. You have a situation in Benton Harbor—is a city of extraordinary depression. I must say, the statistics here are astonishing. Do you have a situation where the city is sort of a core and then there are businesses outside who have fled the city to suburbia?

Mr. **Jackson**. We have a sister city in St. Joe, Mich. which is right across the river and we also have surrounding townships. Our total community is approximately 40,000 people. We have overwhelming surrounding support. We have it documented in here by all of those political units that they want an enterprise zone built in Benton Harbor. They do not fear the crossing of the lines that other people fear. They feel that it is similar to taking a rotten apple out of the barrel; you get a better barrel.

Mr. **Mitchell**. What that means, Senator, is that the fact that Benton Harbor is located in such close proximity, the effects of what is happening in Benton Harbor spread out into the rest of the community. In other words, because we are right in the middle of the rest of them, we need to be like the rest. There has been the flight of people and businesses from the city of Benton Harbor to the outside, as you said.

Senator **Chafee**. Mr. Jackson, how would this help you? Do you think you would end up employing more people? I know that it would reduce your taxes and so forth if you are making any money now, but how is this going to help employment in the inner city where you are now?

Mr. **Jackson**. Senator, I have a very nice facility. My total investment in the facility, because of the economic conditions, is $1.50 per square foot. It is fully craned, sprinklered, and insulated.

Because of that and with those considerations, I am making about 3 percent on my income. If we had an enterprise zone that was as proposed here, I would be making about 8 or 9 percent pretax income. With your tax incentives on top, I would be making about 11 or 12 percent equivalent pretax income. That is what would be a normally profitable business.

We feel that these incentives would in fact make it so that a reasonable business could make a reasonable profit with minimal Government interference. We feel you have obtained that.

The support of our area is quite good. Many of our businesses have looked at our area. There is something very typical of a distressed area. There are not a lot of buildings that are cheap that can go in and be had. I am there because I am there. This bill helps me.

It is unique, by the way. This bill takes care of the people that are there. It does not just take care of the people that come in. It takes care of the people that live there, stay there, and grow. Very important.

Senator **Chafee**. Do you think you would grow under this legislation?

Mr. **Jackson**. I will definitely grow under this legislation; yes, I will.

Mr. **Mitchell**. Not only his business but the other businesses in the city, the residents. The attitude of the residents in the past has been affected by the changes in the economy, and one of the things that hasn't been brought out is the fact that the State of Michigan, the cost of doing business in the State of Michigan has helped a lot of the businesses to leave the State itself.

The residents in the city, shall we say a large percentage of them, I think it is 67 percent who are on some kind of assistance. The way the State is set up, a person can make more money by being on assistance than working at the minimum wage.

Mr. **Jackson**. We ran an analysis also of the cost to the Federal Government presently. It would be about $2 to $3 million per year to put that plant in Benton Harbor. You are currently spending tax dollars in excess of $45 million per year to support the unemployed workforce.

Now as you recreate that economy, yes, your forgone revenues would appear on paper to grow, but in contrast, what will happen is that next year it will be cheaper because there will be less businesses that are paying taxes and you will forgo even less.

Also, the $45 million per year annually is increasing by about 10 to 15 percent per year. This will reverse that trend.

Senator CHAFEE. What do you say about the testimony from the AFL-CIO?

Mr. JACKSON. We have organized labor in our area. We were a foundry town with all organized labor. We had off-road equipment manufacturing. Within the last 6 years, they have all gone out of business, four of them before bankruptcy for the cost of doing business, one of them because they did leave because the cost of the labor being used.

The trade unions and so forth endorsed our zone for our area. We do have a problem at the State level, which are looking at the larger areas, the automobile industry, and have sort of wondered how we would fit.

In our area in southwest Michigan, mostly rural, not associated with the large labor movement, the labor in our area and the organized labor do in fact endorse the zone that we have.

Senator CHAFEE. What do you say to that, Mr. Mitchell?

Mr. MITCHELL. I concur with him wholeheartedly. The only thing that I can say to the labor union is to come out and talk to the Government. We are on the firing line every day. We are feeling the effects of the frustrations of the people in the cities. I have to deal with it every day. They need to come out and talk with us.

Senator CHAFEE. Do you agree with that, Mr. Lilly?

Mr. LILLY. I might add that I think that labor unions are only as strong as their employees. As indicated in our testimony, we have very high unemployment. Therefore, anything that is going to create, cause more employment, I think the residents of Benton Harbor are very much in favor of.

Senator CHAFEE. OK, gentlemen.

Mr. JACKSON. The UAW has lost over 3,000 jobs in Benton Harbor over the last 5 years.

Senator CHAFEE. The UAW has lost what?

Mr. JACKSON. Over 3,000 jobs in the last 5 years in Benton Harbor.

Senator CHAFEE. Thank you, gentlemen. We appreciate you all coming and we will bear your testimony in mind, Mr. Ainslie and each of you, and see what we can do.

[Whereupon, at 12:50 p.m., the committee was adjourned.]

[By direction of the chairman, the following communication was made a part of the hearing record:]

SENATOR GARY HART

TESTIMONY ON THE COMMUNITY ASSISTANCE AND REVITALIZATION ACT OF 1983 (CARA), S.634

Before the
Senate Finance Committee
April 22, 1983

Senator Gary Hart
Testimony before the Senate Finance Committee
April 22, 1983

Mr. Chairman, I appreciate the opportunity to testify before the Senate Finance Committee and I commend you for holding hearings on "enterprise zone" legislation. I believe there's much merit in targeting aid in the form of tax incentives to particularly distressed communities. This year, after two years of work, I have introduced my own version of "enterprise zone" legislation, S. 634, the Community Assistance and Revitalization Act of 1983 (CARA), and I welcome this opportunity to describe some of the features of my bill.

Enterprize zone legislation could not serve a better purpose: encouraging businesses to locate and expand in distressed communities, and thus provide needed jobs for disadvantaged residents. No compassionate society can ignore the plight of people living in these distressed communities. By working to revitalize distressed communities, we also revitalize hopes for their residents.

Through the establishment of enterprise zones, the Federal government can augment its efforts to encourage community revitalization. But we must also consider any enterprise zone program an experiment. By no means can it substitute for a general urban policy.

The legislative proposals offered by the Administration and others to provide tax incentives to businesses in distressed areas -- tax credits, elimination or deferral of taxes on capital gains, continued availability of IDBs, and certain employer tax credits -- represent a beginning. But I fear they don't go far enough. They do not provide all the necessary ingredients for such a program to succeed. Consequently, Congressman Parren Mitchell and I have developed our own comprehensive alternative, the Community Assistance and Revitalization Act (CARA), S. 634, H.R. 1735.

To ensure the program's success, I believe enterprise zone legislation must provide more comprehensive and more carefully targeted tax incentives. First, it should contain tax incentives to ensure that small and minority businesses established in distressed areas will survive and expand. But most importantly, it must also ensure that community residents are the primary -- rather than just the "trickle-down" -- beneficiaries. Only if legislation addresses the human side of the equation -- guaranteeing community residents a real stake in the revitalization of their communities, rather than dead-end, short-term jobs -- will a Federal enterprise zone program succeed.

Targeted Business Tax Incentives

Since several studies indicate small businesses create most new jobs, CARA targets its tax incentives primarily to small businesses -- businesses with average annual gross receipts of less than $4 million (Section 221). CARA also has two provisions that would help ensure the success of small businesses in revitalization areas: a so-called "expensing" deduction, and a tax credit to encourage establishment of Entrepreneurial Development Centers (EDCs).

The expensing provision (section 233) allows persons who invest in community revitalization efforts to deduct immediately their investment (up to $10,000). By increasing the effective rate of return an invester can realize on these high risk investments, an expensing provision should create a new pool of venture capital into which small businesses located in distressed areas may tap.

Enterprise zone legislation can also increase the chances that these small businesses will thrive if it encourages the establishment of Entrepreneurial Development Centers (EDCs) (section 223). EDCs could provide small businesses with marketing, financing, job training, and other managerial assistance as well as technical resources such as computer and laboratory services. Under CARA, these non-profit enterprises must assess reasonable fees and conduct at least 50 percent of their businesses in a revitalization area. Not only will EDCs increase business productivity in revitalization ares, they also will reduce the failure rate of small businesses. They have already proven successful in a number of cities.

The Human Equation

Success of this enterprise experiment largely depends on whether poor or disadvantaged persons share directly in the benefits of revitalization efforts. The most promising way of ensuring this is to give residents of a distressed community an equity stake in its revitalization. For instance, enterprise zone legislation should encourage community-run development corporations. CARA does just this by creating incentives for but not necessarily requiring, establishment of General Stock Ownership Corporations (GSOCs) in revitalization areas.

Wherever possible, tax breaks and subsidies offered to businesses in enterprise zones should directly benefit employees. CARA has a number of tax incentives to promote Employee Stock Ownership Plans (ESOPS) (Title IV) where employers share ownership of their businesses with employees. The experience of recent years, has shown that ESOPs increase the satisfaction of employees with their work and frequently enhance productivity. Encouraging employee-owned businesses is a good way to keep jobs and economic benefits flowing to the residents of revitalization areas.

The Internal Revenue Code (section 1391) already recognizes, for tax purposes, General Stock Ownership Corporations (GSOCs) which give state residents an equity stake in their state's development. CARA would apply this concept to revitalization areas (Title III). CARA provides a number of tax incentives for investing in GSOCs -- such as charitable contribution deductions and reduction in capital gain tax. Consistent with the GSOC concept, CARA allows only revitalization area residents to own the GSOC stock and direct the activities of their community's revitalization. Through the revitalization area GSOC residents can (1) limit the adverse consequences of residential displacement, (2) take advantage of the appreciation in value of accompanying development, and (3) determine the types of businesses that will be encouraged to locate in the community. Earnings from its real estate development activities, and from its investments in other businesses should return profits to the revitalization area GSOC and ultimately dividends for resident shareholders.

Other Features of CARA

CARA contains a number of other features that would be beneficial as part of enterprise zone legislation. These provisions include: increased tax credits to encourage energy conservation in area homes and businesses (Title V); earmarking of $50 million in direct loans by the Small Business Administration for small revitalization area businesses (section 234); rollover of the capital gains for the sale of an investment regardless of its location if reinvested in a revitalization area (section 221);

establishment of up to 205 revitalization areas to ensure a truly diverse enterprise zone experiment (section 101). In addition, to prevent businesses from relocating to revitalization areas solely to obtain the tax benefits, CARA allows the IRS to recapture tax benefits from businesses that decrease their business activity within three years of relocating in a revitalization area (section 201). And, in order to ensure a proper evaluation of this experiment, every fourth year the Housing and Urban Development Secretary must submit to the Congress a report on the results of each enterprise zone program.

Finally, in its eligibility criteria for revitalization areas, CARA reflects its general concern that this program primarily benefit community residents. CARA does more than simply ask state and local government to make efforts to reduce taxes, reform regulations, improve local services, and assist community groups. It specifically seeks coordinated and comprehensive commitments to increase equity for residents and employees; provide job, managerial, and entrepreneurial training to residents; make available financial, managerial and technical assistance to area businesses; increase energy efficiency; and limit displacement of residents from low and moderate income housing in the revitalization area. CARA calls for a 2-step designation process to reduce the burden on local governments of making commitments without any preliminary indication of their chances of receiving revitalization area designation.

And, to complement and embrace each states' enterprise zone program, CARA would give preference to a distressed community that the state has already designated an enterprise zone.

Mr. Chairman, a Federal enterprise zone program will only succeed if it is part of a concerted Federal effort to promote economic revitalization. It must be both comprehenisve and carefully-targeted; and it must directly aid not only businesses, but also residents of, distressed communities. I offer CARA as an alternative to other enterprise zone legislation proposals, and hope that this Committee will incorporate many of its provisions in the legislation it reports.

Thank you, Mr. Chairman.

Jack Kemp

TESTIMONY OF THE HONORABLE JACK KEMP (R- N.Y.) ON THE ENTERPRISE ZONE ACT OF 1983
BEFORE THE SENATE FINANCE COMMITTEE
FRIDAY, APRIL 22, 1983

Mr. Chairman and members of the committee, I want to thank you for giving me this opportunity to testify on behalf of the Enterprise Zone Act of 1983 , which Representatives Conable, Garcia and I have introduced in the House of Representatives as H.R 1955.

Let me say how pleased I am that the idea of providing incentives to create jobs and revitalize our depressed areas through creating an open, free-market environment has gained such strong support. To quote Tom Bethell, " An economy is precisely kept in a dynamic state by two powerful forces: the push (from the bottom) of those escaping poverty, and the upward pull or the magnetic attracion of wealth." This is precisely the rationale behind the Enterprise Zone concept -- to restore incentives for that "push" and "pull".

Over the last three years the coalition for enterprise zones has grown, and is continuing to grow with the concept being endorsed by one organization after another. The National Urban League, the NAACP, the League of Cities, the National Urban Coalition and members of the Congressional Black Caucus have all endorsed the concept of enterprise zones. Both the Republican and Democratic platforms urged that this idea be explored back in the summer of 1980. Mayors accross the Nation have applauded this iniative, and enterprise zone committes, conferences and task forces have been springing up over the past several years.State legislatures have debated and many have passed enterprise zone legislation. And now, President Reagan has committed his administration to establishing enterprise zones in the Nation's poorest urban and rural communities.

The enthusiasm reflect, in large part, the frustration we can see with the wasteland of ideas for helping cities. The key behind the enterprise zone concept is that poor people are not some special helpless class. Despite their predicament, the poor have the same goals and aspirations as other Americans. They want to be productive and self-sufficient in providing for their families. They want jobs, they want to be able to save and invest. But they need tangible economic opportunities, which are now missing from our inner cities and many of our rural areas.

We must unleash the productive capability that exists in the minds, hands and creativity of the people. People will take a chance on a better future, they will invest their human capital, if they believe they have some chance to succeed. This is true of the poor and it is true of the entrepreneur as well.

A principal aim of enterprise zones is to overcome barriers to the expansion and formation of the young or new small businesses which create most jobs. One of the highest of these barriers is the scarcity and high cost of financing, especially the risk capital which will be required for successful growth in enterprise zones.

Future-oriented tax incentives make more capital available in the present. By reducing capital gains and income taxes, in particular, the Enterprise Zone Act of 1983 promises a greater reward to those who succeed in their initial risk-taking investment. In this way we tap the greatest resources available -- the huge pool of private resources seeking a significant, after-tax rate of return in these uncertain times.

Growing small businesses account for most net new jobs and a disproportionate share of economic growth. What these vital small businessees need most is start-up venture capital. The vast majority of it comes from personal savings of the entrepreneur, followed by individual investors. Lowering the tax on small business income only helps the business after it begins to make a profit, which may not happen for a few years.

The elimination of taxation of capital gains derived from investments in the zone is important, but it is not sufficient to generate the needed investment. Further, tax credits are of no help when there is no tax against which to apply the credit, this is the probable case in the early, starting-up years of a small business. What is needed is a means by which current year risk taking will be rewarded with current year tax savings -- or "equity expensing".

Such an arrangement would enable investors to deduct immediately (up to some limit) the cost of purchasing enterprise zone stock or debentures. By offering an immediate tax advantage it would help attract upfront capital, and significantly improve its rate of return.

While I stand in full support of this legislation, I would strongly recommend adding an expensing provision to attract additional capital to enterprise zones.

The Department of Housing and Urban Development's enterprise zone selection process will be highly competitive. The primary criteria for choosing which proposed zones will receive Federal designation will be the quality and strength of the incentives to be contributed by the State and local governments.

A number of cities are known nationally for their existing commitment to urban revitalization. With or without Federal assistance, with or without aid from business, they have already made the maximum effort by providing substantial resources for zone-eligible areas. Yet the way the Act is structured, such past commitments are not given a high degree of importance in the zone selection process. I feel that it is important that the selection process recognize applicants that have a successful record of significant past efforts. I would strongly support an amendment that would provide for the inclusion of granting credit for past activities in the selection process.

I am pleased that this legislation provides for a 5% employee nonrefundable tax credit. I felt last year, when this committee dropped this particular element from the package of economic incentives, that the bill was severely weakened.

We must remember that, etween giving up welfare benefits and paying taxes, the poor, who want to stay off welfare face what are, effectively, the very highest marginal tax rates of all. Retention of the employee tax credit reduce the tax rate faced by individuals leaving welfare for work, and will also provide an important incentive for skilled workers and managers to take jobs in the enterprise zone areas. When it comes to his or her own personal welfare, every person is an entrepreneur. Everyone makes economic calculations. A person, today, who gives up welfare or unemployment benefits to take a job that provides scarcely more, if any, in after-tax income than the public assistance benefits provide is just not being realistic. But that is exactly what we ask of our poor. I feel that it is vitally important that this element of the economic incentives package be retained.

I am pleased, in closing, to say that I am glad to see the extent of support of enterprise zones exhibited here today and am proud to have been involved in the process that has brought this important piece of legislation so close to being a reality. I hope that it moves swiftly, because I do not believe that the country can wait. Our economic recovery has begun -- but we must also reach out further and target those areas of the country, urban or rural, that are worst off. We must all move ahead and we cannot leave anyone behind.

The concept of enterprise zones has been a long time coming and I, as an original supporter of this idea, am dedicated to helping perfect the bill and enacting it into law. It is a vital measure to bring hope to the disadvantaged, the poor and the unemployed and to let them know that we have not forgotten our goal of justice, opportunity and prosperity for all.

Rec. - Apr 22

COMMUNITY DEVELOPMENT COMMISSION
COUNTY OF LOS ANGELES

1436 GOODRICH BOULEVARD ● COMMERCE, CALIFORNIA 90022
(213) 725-7422

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UNITED STATES SENATE
FINANCE COMMITTEE

STATEMENT ON S. 863

As Director of the County of Los Angeles Community Development Commission, I want to thank you for the opportunity of presenting my views on Enterprise Zone legislation.

Los Angeles County is the most populous County in the United States. With a population larger than that of 42 states, our County has 83 cities within its borders. The five-member County Board of Supervisors, our Commissioners, has delegated to the Commission responsibility for economic development programs and the coordination of commercial and industrial activities for our 7 million residents.

We have followed Enterprise Zone legislation closely from its inception, and agree with the concept. There is potential for economic development within blighted areas of our country.

We note with approval changes from the Enterprise Zone Tax Act of 1982, relating to exemptions from NEPA and shift of certification responsibility from HUD to state and local governments.

However, we have concerns about the legislation as it is presently drafted.

The proposed criteria for eligibility were obviously drafted to qualify urban areas in the Northeast, where unemployment and blight are compacted. Under these criteria, few Los Angeles County census tracts could qualify. Therefore, it is the Board's position that qualification of zones be based on local, as opposed to national, demographic comparisons.

Specifically, we recommend the legislation be modified in this manner:

- Change the method of determining the median income and the percentage of residents required to be low income from combining families and related individuals into a single base, to treating them separately when comparing them to the median income in the county.

- Provide that the local Standard Metropolitan Statistical Area unemployment rate and Aid to Families with Dependent Children data be used in zone designation, instead of national unemployment statistics.

- Provide that areas experiencing large population increases, as well as decreases, be considered for Enterprise zone legislation.

- Provide that the number of zones be based on need, rather than an arbitrary limit of 25 zones per year.

In addition, the requirement that a jurisdiction be eligible for an Urban Development Action Grant, or the applicant community have a "pocket of poverty" designation, poses a handicap on our distressed areas.

Los Angeles County represents a diverse collection of communities, most having their own city governments of 82 mayors and 346 councilmembers. These incorporated cities may be considered separately for UDAG eligibility. However, communities in the unincorporated portion of the county must all be considered together. This results in communities such as East Compton being lumped together with a far wealthier area such as Malibu in determining an overall statistical average.

This method is unfair to a distressed community miles apart from a wealthier one. The distressed community must be considered under the more stringent "pocket of poverty" designation while adjoining incorporated cities with similar symptoms of distress are able to qualify as UDAG eligible.

The UDAG criteria, which focus on the age of housing and population decline--greater factors in the East--were not created with Enterprise Zones in mind. Therefore, we ask you not to impose them on us in Enterprise Zones, OR to amend the legislation to allow distinct, separate unincorporated communities to be considered individually for UDAG eligibility, rather than the county as a whole.

Other areas that Congress may wish to consider for amendment are:

1. Extension of tax incentives in the legislation to include lenders who grant loans within a zone, and

2. Extension of similar incentives to insurance carriers who insure within a zone.

These incentives may be particularly helpful in inducing investors and lending institutions to provide start-up capital for new or smaller businesses.

In addition to specific legislative amendments, I understand your committee is seeking input on the role local governments should play in "administering" a zone. We in Los Angeles County believe the least zone administration at the local level will be best. This is in accord with the overall goal of the Enterprise Zone concept to reduce layers of government regulation. It is our position that the overall purpose of administration at the local level is to provide the foundation, deliver services and expedite the required review process with as much speed and simplicity as possible.

In recognition of the fact that (1) only 25 zones will be designated nationwide during the first year, and (2) urban problems transcend municipal borders, our County Enterprise Zone Task Force is working with the City of Los Angeles and others to identify potential zone sites, and to develop incentives necessary for local economic development to occur.

We in Los Angeles County are committed to putting together a strong Enterprise Zone proposal. I thank you for seeking our input, and look forward to achieving our mutal objectives, revitalization of our urban centers.

Hearings Held in Senate Finance Committee April 22, 1983

May 6, 1983
Statement of the

COMPONENTS GROUP
of the

Electronic Industries Association (EIA)
to the

Senate Finance Committee
on the

Enterprise Zone Employment and Development Act of 1983, (S.863)

The Components Group of the Electronic Industries Association (EIA) supports the concept of the proposed Enterprise Zone legislation (S.863), but opposes the provision that encourages the establishment of foreign-trade zones within enterprise zones.

Four of EIA's Divisions comprise the Components Group. The Tube Division is composed of United States manufacturers of electronic tubes; members of the Parts Division manufacture various passive and electromechanical electronic components; members of the Solid State Products Division manufacture semiconductor devices and electronic chips; the Distributor Products Division's members are manufacturers of components who sell their products through electronic distributors. Together, the Components Group represents over 250 large and small manufacturers.

Title IV, Section 401 of S.863 encourages the establishment of foreign-trade zones by directing the Commerce Department's Foreign-Trade Zones Board to "consider on a priority basis and expedite, to the maximum extent possible, the processing of an application involving the establishment of a foreign-trade zone within an enterprise zone..." The Bill further directs the Secretary of the Treasury to "consider on a priority basis and expedite, to the maximum extent possible, the processing of any application involving the establishment of a port of entry which is necessary to permit the establishment of a foreign-trade zone within an enterprise zone."

We believe such encouragement of the proliferation of foreign-trade zones would not be in the best interest of the United States for the following reasons:

1. The Administration of Foreign-Trade Zones is Inconsistent with the Concept of Enterprise Zones

"The Administration's Enterprise Zone Proposal", upon which this legislation is based, states (page one), "Concept. The Enterpirse Zone concept is based on utilizing the market to solve the problems of the Nation's economically depressed areas, relying primarily on private sector institutions. The idea is to create a free market environment in these areas through the removal of taxes, regulations and other government burdens. The removal of these burdens will create and expand economic opportunity within the zone area, leading to the economic revitalization of these areas and to real, private sector jobs...." (emphasis added). The removal of government regulatory burdens is a laudable concept. We believe, however, that the administration and operation of a foreign-trade zone is incompatible with this concept. Application to become a foreign-trade zone involves conformance with many regulations and must include a detailed explanation of planned operational procedures. Moreover, once an application has been approved, the administration of a foreign-trade zone is subject to numerous regulations controlling the flow of goods in and out of the zone. In addition, foreign-trade zones are required to remain accessible to government officials at all times so regulatory conformance can be verified. And these regulations cannot be waived; indeed, the majority of them are necessary and desirable.

It is our belief, therefore, that encouragement of foreign-trade zones within enterprise zones is contrary to the concept of removing burdensome government regulation.

2. Injury to U.S. Domestic Manufacturers

Due to certain inconsistencies in the law, a phenomenon known as "inverted tariff" can be exploited through the establishment of a foreign-trade zone. In a number of instances, U.S. tariff rates are considerably lower on assembled products than on their components. For example, the tariff on typewriters is 0%, on automobiles is 2.9%, on TV sets is 5%; however, the tariff on their key components is in the 14%-18% range. If foreign articles enter a zone or subzone as components and leave the zone as assembled products, the assembling party has the option of paying tariff on either the assembly (finished product) or the component parts. The combination of inverted tariff with assembly inside of a foreign-trade zone is extremely distrubing because it encourages manufacturers to import components instead of procuring or buying them domestically. It is noteworthy that this combination is being exercised primarily by foreign-owned subsidiaries domiciled in this country and operating within a zone or subzone. They use the foreign-trade zone mechanism to gain unfair commercial advantages over their domestic competitors and can cause substantial injury to U.S. manufacturers.

In formal statements to the Foreign-Trade Zones Board, we have objected to such use of foreign-trade zones. We contend that when used in such a manner, foreign-trade zones become a device for the purposeful circumvention of U.S. customs duties and, thereby, for gaining unfair commercial advantages. Until such unintended use of foreign-trade zones is corrected, we feel that encouraging their proliferation is inappropriate.

• • •

In the past two years, the growth in the number of foreign-trade zones has been dramatic; their proliferation needs no encouragement. Most importantly, foreign-trade zones pose a threat to domestic manufacturers and, in the nature of their operation, are contrary to the underlying concept of enterprise zones. We believe the encouragement of foreign-trade zones is not in the best interest of

U.S. manufacturers and that the combination of foreign-trade zones within enterprise zones is not in the best interest of the U.S. economy. We urge the Senate Finance Committee to remove from S.863 any provision for foreign-trade zones or for ports of entry in conjunction with enterprise zones.

A Mandate For Leadership Report

Agenda '83

Edited by

Richard N. Holwill

The Heritage Foundation

THE ENTERPRISE ZONE INITIATIVE

by Stuart M. Butler, Ph.D.

The Administration should press forward vigorously with its Enterprise Zone initiative. The concept offers many potential benefits for both the inner cities and the White House. The creation of genuine, lasting jobs in the inner cities is critical to the revival of the country's major urban centers. Equally important, the Administration must show that free enterprise works in the ghetto, as well as in the suburbs and Silicon Valley. If the President does not carry through with his commitment to the Enterprise Zone proposal, bitterness and disillusionment in the inner cities will result in pressure to restore the wasteful programs and urban slush funds that quite properly were cut during the last two years.

Although the Enterprise Zone idea was the centerpiece of Ronald Reagan's urban platform during the 1980 election campaign, progress on the proposal has been painfully slow despite the Administration's repeated assurances that it remains among its highest urban policy priorities. Conflict and confusion within the Administration itself over the objectives of the proposal have contributed to the delay. Some officials—chiefly those at HUD—have favored a truly experimental approach, with tax and regulatory changes aimed at creating a climate of small-scale entrepreneurship in depressed urban areas. In this approach, the exact pattern of the zone development cannot be predicted with certainty, but it is more likely to lead to real innovation and enterprise. Other officials—chiefly at Treasury—seem reluctant to allow experimentation. Like typical bureaucrats, they would prefer an Enterprise Zone program that is easy to manage and predictable in its outcome.

On several occasions during the last two years, the President has been forced to intervene personally to ensure that the initiative did not become bogged down within the executive branch. The White House will have to increase these efforts to move the concept forward if the final product is to bear any resemblance to the original idea of a series of bureaucratic-free inner-city zones, where job-creating entrepreneurs are given the chance to revive the neighborhood.

The White House must also increase its efforts to ensure passage in Congress. Senate support is strong. Support in the House is from both sides of the aisle. The Democratic leadership in the House, however, has bottled up the concept for almost two years. Not a single Democrat on the powerful Ways and Means Committee has cosponsored the bipartisan bill.

In pressing for passage in Congress, Administration officials should seek three principal objectives. First, the program should be limited to 75 zones and be free of appropriations. A limit on the number is necessary to maintain competitive pressure on applicant cities, inducing them to cut local regulations and taxes, and the absence of any appropriation is needed to prevent the concept from becoming another urban boondoggle. Secondly, the tax incentives must reflect the fact that the Enterprise Zone was conceived as a mechanism to generate new, small, locally owned businesses in depressed urban neighborhoods. Unlike urban renewal, it is not a strategy to level existing communities in the interests of big business. The emphasis must be on tax incentives and regulatory relief that reflect the needs of small concerns. In particular, incentives for investors in small zone firms should be a major element in the package (since the chief worry of new businesses is capital, not taxes). Thirdly, neighborhood organizations, critical to the success of the program, should be recognized as such. Community organizations have a proven track record in tackling crime and other barriers to business formation in the cities.

In administering whatever program is finally passed by Congress, HUD should give priority to cities that make real efforts, in conjunction with the state, to remove barriers to small businesses and neighborhood organizations. In deciding which zone applications should receive federal approval, particular attention should be given to revision of local rules, such as zoning, permitting, and building codes, which frustrate small firms and inhibit the reuse of older buildings; and to easing of occupational licensing, which poses major obstacles in the path of voluntary associations willing to provide day care, security, and other services.

The Administration has already lost the initiative. Enterprize Zone has ceased to be the keystone of its urban policy, and slowly but surely the name is being hijacked by bureaucrats, planners, and consultants who are seeking to distort the Enterprise Zone into a program to ensure their continued employment at the taxpayers' expense. The White House must move swiftly and decisively to prevent this and to get the concept back on track.

Rec - [illegible]

STATEMENT OF SOL C. CHAIKIN, PRESIDENT INTERNATIONAL LADIES' GARMENT WORKERS' UNION, TO THE SENATE COMMITTEE ON FINANCE ON S. 98 AND S. 863, ENTITLED "ENTERPRISE ZONE EMPLOYMENT AND DEVELOPMENT ACT" AND "ENTERPRISE ZONE EMPLOYMENT AND DEVELOPMENT ACT OF 1983", AND ON S. 634, "COMMUNITY ASSISTANCE AND REVITALIZATION ACT OF 1983"

May 3, 1983

Just about a year ago I appeared before a Subcommittee of this Committee in behalf of the International Ladies' Garment Workers' Union of which I am President and of the AFL-CIO of which I am Vice President and member of the Executive Council. I spoke in opposition to President Reagan's proposal to establish urban enterprise zones. In the course of the year that has passed, the views of organized labor and of the ILGWU, for which I make these comments, have not changed. My views supplement those made by the AFL-CIO on April 22, 1983.

The concepts embodied in S. 98 and S. 863 continue to be based on the false premise that the way to create jobs is to provide incentives for business in economically depressed areas through tax abatement and exclusive reliance upon private sector institutions. This "fresh" approach, I argued one year ago, would not serve to arrest and reverse the impoverishment and obvious decay in the inner cities of our country. Nor, I said, would it do any more to alleviate suffering, despite its high flown language, than any other aspect of the President's economic program.

Even today, as we are being told that the United States is in the midst of a healthy recovery, more than 11 million workers are unemployed, an additional almost 2 million workers have given up hope of finding a job and another 6.5 million who want to work regular hours are working short hours.

The premise of these bills is no different than the economic premises with which this Administration has operated for more than two years:

tax breaks to all except those who really need them will create recovery in the economy. The sponsors of the current legislation have also turned a deaf ear to the pleas of the states and localities that the Administration end the increased pressures on their already overburdened financial structures through its New Federalism policy.

There is nothing substantively new in the two bills currently before you. They still have a close kinship with the original plan to modify or eliminate minimum wages and lift protective legislation dealing with public health, occupational safety and further destruction of the environment. Nor is the origin of these proposals any less obscure than the prior one. It is still an imported economic concept, brought in "duty free", of course, from the United Kingdom governed by an Administration with a similar ideological outlook. The scheme has been no more successful in creating jobs in that country than it can be in the United States.

My reasons for saying this are obvious. Despite the mysticism of the virulent supporters of the free trade concept, jobs, particularly sorely needed labor intensive jobs, are generally created by small business. Investment is made by small businessmen when they feel they can make a product and sell it at a profit. They expand their production when the demand for their goods is greater than their current capacity and in the expectation that they can produce more and sell more and make more profit. I certainly have no argument with this and I know small business well. It is characteristic of the industry in which the members of my Union work. Our industry provides entry level jobs as it has for a hundred or more years. It is, in fact, the last bastion of free democratic, competitive capitalism in this country: there are presently more than 25,000 garment and apparel factories; they currently employ an average of about 40 workers in each shop -- some more, many less.

Our industry is precisely the kind of industry the President and his backers on urban enterprise zones seem to have in mind. But, they seem unaware or uncaring that this industry is being destroyed by a combination of massive increases in imports and a continuing recession in the economy. Let me cite just a few figures.

By the end of 1982, 41 out of every 100 garments consumed in the United States were imported. This compares with 4 out of every 100 a mere 25 years ago. In the first three months of this year, apparel imports increased by 17 percent over the same period a year ago. Although domestic production data are not yet available, we do know that domestic employment in apparel dropped in these three months by 30,000 workers. Imports have, thus, taken almost 700,000 job opportunities away from apparel workers in this country. Neither the President nor the sponsors of this legislation seem to be much concerned about this situation, despite the fact that the legislation before this Subcommittee is, in large measure, ostensibly aimed at providing employment for precisely just such workers.

Nor is there any apparent awareness that many additional jobs have been lost as a result of the massive proliferation of undocumented workers. These workers are forced, because of their status, to work in shops operated by unscrupulous businessmen who constantly violate basic laws that protect workers, especially the Fair Labor Standards Act.

Anyone familiar with small business knows that there are few ties that bind a labor intensive plant to a given area. Such factors as raw materials and power availability are not of major import. The chief requirement is an abundant supply of labor that, with brief training, can fill the needs of the company. Small scale and low capitalization levels make such industries very mobile. They also provide a key source of employment for members of minority groups, for women and for recent immigrants, many with language problems.

It is no great secret that many small scale, labor intensive industries, including apparel plants, already exist in distressed urban areas, the very areas the proposed legislation purports to aid. The factories are there because the labor supply they need is there.

A number of obvious negative scenarios stem from the urban enterprise concept:

-- rather than create new jobs, the proposed legislation would merely shift existing jobs from one depressed area to another;

-- fly-by-night and other unscrupulous employers would take advantage of the legislation to make a quick killing and then depart;

-- other unscrupulous employers would use zones as a way of further degrading and, yes, exploiting those undocumented aliens who fear for their very security because of their status and those with language barriers who are unable to make their voices heard effectively;

-- violation of protective labor legislation would grow at an even more precarious rate than present limited enforcement by federal authorities encourages.

We have witnessed at an increasing pace the extent to which jobs have been destroyed in our industry, a key labor intensive industry, by importers unconcerned with the welfare of our people and by employers who flout the laws of the land. The proposed legislation would, at best, permit the shifting of jobs -- in fact, it would encourage it on the part of those employers seeking to exploit tax breaks.

This Committee should be aware that in apparel. as in other labor intensive industries, labor constitutes a major cost of production. In apparel it is about one-third of the wholesale price. Are the sponsors of the enterprise zone proposal really asking that circumstances be created by the Congress of the United States in which American workers who average something over $5 per hour, excluding fringes, work at levels paid to workers in Asia and elsewhere - 10¢ per hour in Bangladesh, 16¢ per hour in China and 63¢ per hour in South Korea? How else will new jobs be created in the labor intensive apparel industry plants located in enterprise zones in view of the import-inspired decline in domestic production? Do they really consider $5 per hour, the average wage of apparel workers, to be excessive?

I have alluded before to the fact that jobs under the proposed legislation would be shifted from one needed area to another. A further point along these lines should be made. Each impoverished and disadvantaged community would be asked under the proposed legislation to bid against a similarly deprived community to attract firms. And, in addition to further eroding the tax bases and community services facilities, the legislation would lead to even greater declines in living standards and increased segregation of poverty areas.

We strongly favor the rebuilding of our inner cities and the creation of new jobs. We are convinced, however, that in order to be effective a coordinated national economic plan is needed, one that would also address the geometric growth of imports and the consequent further destruction of labor intensive jobs. As I suggested one year ago, such a program would involve all sectors of the economy and make use of all of the tools at the government's disposal.

In this context, we find some positive elements in S. 634, the Community Assistance and Revitalization Act of 1983, perhaps most important being the fact that it is not viewed as a substitute for a comprehensive urban policy and clearly recognizes the shortcomings and negatives of the enterprise zone concept.

We are sympathetic with the bill's "percolate-up" concept, but we believe that real revitalization can only be national in scope. This does not mean that we do not favor urban development action grants and community development block grants, reestablishment of revenue sharing, a long-term commitment to rebuild the nation's infrastructure. However, we feel less sanguine about retraining displaced workers and long-term unemployed unless specific job opportunities are created and such workers are specifically trained for these jobs; training for non-existent jobs simply exacerbates human suffering.

We welcome the concept in S. 634 that the major issue is a national one, that the President's current policies must be abandoned in favor of a national economic policy that will truly put us on the path to short-term revitalization and long-term growth. These concepts should be the basis of the current hearings of this Committee, rather than preoccupying itself with the counterproductive game-playing concepts of enterprise zones. Crucial to a more realistic view of how to rebuild America and create new jobs must be a recognition of the specific needs of both smokestack and labor intensive industries.

Urban enterprise zone legislation before this Committee remains a delusion and a diversion from the real problems facing our inner cities. It continues to be, as I stated one year ago, "part of a broader, sugar-coated strategy aimed at the hard-won protective legislation for the workers and the poor of our nation, organized and unorganized, a weakening of organized labor and additional giveaways to the business community without requiring any reciprocity to the nation as a whole."

Members of the Committee: Unless we all come up with a program that will truly create millions of new jobs without further degrading our economy, we all will be held responsible by history for having participated in one form or another in the destruction of the standards of life and work that has made America the envy of the world.

Remarks of A. Mitchell McConnell, County Judge/Executive
Jefferson County, Kentucky
to
The U.S. Senate Committee on Finance
May 3, 1983

Mr. Chairman and honorable members of the Committee: The United States, as I feel we can all agree, is suffering the most radical transformation of our economy since the industrial revolution. Some communities, mine among them, are suffering more than others.

As we move from the industrial age into the information-based era, it is the less-educated blue-collar worker and the older, manufacturing oriented urban communities which are the hardest hit. And, while the shift from agriculture to industry took place over a century or more, it is estimated that the current transition is occurring over a time span of around twenty years. If the industrial shift was a revolution, the move to an information-based, technological society can be termed a whirlwind.

Enterprise zone legislation on the federal as well as the state and local levels offers the most promising and thrifty means to enable cities to tap existing market forces, leveraging new company formations and expansions within the very areas which are now blighted and abandoned by receding industries, and providing employment for the now-unemployed residents of these areas. I would like to encourage this committee to consider and expeditiously report out (House Resolution 1955 or Senate Bill 863).

We have moved ahead in Kentucky with zone enabling legislation and the city of Louisville has submitted a very fine proposal for an inner-city zone to a state commission which will designate two zones later this year. We hope and expect that the Louisville zone will be selected, in later years if not in the first round. But to experience the zone's full potential in company formation and job creation, we need the federal legislation which this committee has under consideration.

In efforts to attract entrepreneurial activity to inner city communities, the primary consideration is providing an expected rate of return to the investor which is competitive with what he or she might achieve elsewhere. Less attractive surroundings, inefficient older buildings, a relatively uneducated, less productive work force, vandalism and crime rates and the high property and use taxes typical of declining cities all contribute to a substantially higher cost of doing business and must be compensated for before investors will consider locating in the city's neighborhoods.

A recent industrial survey performed by the Louisville Area Chamber of Commerce found that 46% of the firms within the city limits of Louisville consider the quality of their neighborhoods to be a problem, contrasted with only 15% of the firms located outside the city. Likewise, 58% of the city firms reported security as a problem, against 22% in the county balance; and 27% of the city companies complained about the condition of their plant while only 10% of the outlying firms did.

The designation of an urban enterprise zone encompassing a large portion of Louisville's underused or vacant industrial-zoned property would give a boost to efforts to attract expansion and start-ups within the city, especially since enhanced security and other services are among the required benefits of enterprise zoning under the state legislation.

The major two elements of zone relief, however, lie of course in the areas of taxation and government regulation of businesses. The latter is perhaps even more meaningful to the small, innovative business which we are most eager to foster than the second, although tax relief is more specifically mandated in the federal bill proposed to this committee.

The Kentucky enabling legislation, unlike that of some other states, specifically provides that enterprise zones may be exempted from local regulations unless doing so endangers the health or safety of the citizens. The local zone authorities in Kentucky also will be required to review all state regulations affecting businesses and recommend to the administrative bodies exemption from regulations where considered appropriate.

Thus, companies starting or expanding within Kentucky zones will be afforded relief from some of the "hidden taxation" represented by regulatory redtape, as judged safe and effective by the city and state. The creativity of the local authorities and companies will be brought into play through this provision in the state law as, without endangering health or safety, the local and state regulatory environment is simplified. This element of the zone concept typifies the trend toward self-reliance on the part of individuals, companies and communities, permitting different locales to tailor regulations to fit their particular marketplace and mix of residents.

The tax relief elements of both the federal legislation proposed and the legislation in Kentucky and other states is quite significant in terms of attracting investment to the zones. It is not, however, quite as helpful to the emerging company as it is to the expanding, already-profitable one.

We know from research by the Brookings Institution and other studies that substantial job creation and technological innovation come from newer, smaller firms, and that they are flexible enough to fill the void left by the dying or shrinking large corporations. In fact, a shift-share study conducted by the University of Louisville's Urban Studies Institute in 1979 found that companies in the Louisville SMSA with fewer than 20 employees accounted for 55.3% of the total growth in employment from 1972 to 1977. Nationally, this size firm produced 47% of employment growth, still a large number but not as great a percentage as in our declining manufacturing city.

Likewise, a survey by Jefferson County's business retention program during 1982 indicated that companies with under 26 employees were the only size category to have gained employment during a three-year period in which the companies surveyed lost an average of 18.5% of their 1979 employment. And Louisville and Jefferson County especially need a strong comeback on the part of new entrepreneurs to make up for the almost 20,000 jobs that have been lost since 1974 among our twelve largest industrial employers -- jobs that likely will not be refilled.

The establishment of federally-authorized zones would multiply the advantages to these emerging companies we hope will locate and thrive and provide employment in our enterprise zone. I urge you to also consider the proposed "expensing provision," or a similar amendment which offers immediate capital assistance to the pre-profitable company, to help them even more in the first rough years.

Aside from the very real technical and financial benefits promised by zone formations, contemplate as well the intangible but no-less-real lift afforded a community and its residents. In closing, I again respectfully urge you to move quickly to offer federal legislation to compound the benefits promised by state and local action. I agree with many of you that the direct tax revenue lost through tax abatements will prove miniscule compared to the income realized through future income and corporate tax payments, property tax on revitalized city real estate and lessened welfare payments. Thank you very much for your time spent in consideration of this most vital matter.

May 4, 1983

STATEMENT OF THE NATIONAL COUNCIL FOR URBAN ECONOMIC DEVELOPMENT

TO THE SENATE SUBCOMMITTEE ON SAVINGS, PENSIONS, AND INVESTMENT POLICY

MR. CHAIRMAN AND MEMBERS OF THE SUBCOMMITTEE:

THE NATIONAL COUNCIL FOR URBAN ECONOMIC DEVELOPMENT (CUED) IS PLEASED TO BE ABLE TO OFFER THIS STATEMENT ON S. 863, THE ENTERPRISE ZONE EMPLOYMENT AND DEVELOPMENT ACT OF 1983. THIS LEGISLATION CONTAINS IMPORTANT INVESTMENT AND JOB GENERATING INCENTIVES WHICH ARE OF GREAT INTEREST TO CUED AND ITS MORE THAN 1,000 MEMBERS, WHO PLAN AND IMPLEMENT ECONOMIC DEVELOPMENT ACTIVITIES IN MORE THAN 400 CITIES AROUND THE COUNTRY.

S. 863 PROPOSES TO COMBINE FEDERAL TAX CREDITS WITH LOCALLY-DESIGNED INCENTIVE PROGRAMS TO PULL INVESTMENT AND JOBS INTO TARGETED DISTRESSED URBAN AREAS. THUS, ITS ENTERPRISE ZONE INCENTIVES ARE SIMILAR TO A TAX-SIDE ENTITLEMENT PROGRAM. ONCE A FIRM LOCATING WITHIN A ZONE MEETS THE MINIMUM QUALIFICATIONS, IT IS ENTITLED TO THE BENEFITS. THE LACK OF DIRECT FEDERAL CONTROL CONTRASTS SHARPLY WITH OTHER DEVELOPMENT PROGRAMS, IN WHICH THE SIZE OF THE SUBSIDY AND THE EXTENT OF THE ASSISTED ACTIVITY FLOWING TO A PARTICULAR AREA CAN BE REGULATED.

THE ENTERPRISE ZONE PROPOSAL IS FUNDAMENTALLY A TAX PROGRAM AIMED AT PROMOTING URBAN DEVELOPMENT, RATHER THAN A TRADITIONAL ECONOMIC DEVELOPMENT PROGRAM. HOWEVER, THE INGREDIENTS NECESSARY TO FOSTER ECONOMIC REVITALIZATION REMAIN THE SAME.

FOR ECONOMIC DEVELOPMENT TO OCCUR, WHETHER IT BE A SINGLE PROJECT OR AN ENTIRE TARGETED AREA, THE ENVIRONMENT MUST BE CONDUCIVE TO INVESTMENT. THE COMPONENTS OF THIS ENVIRONMENT, ALL OF WHICH MUST BE PRESENT FOR DEVELOPMENT TO TAKE PLACE, INCLUDE:

- AVAILABILITY OF SUITABLE LAND OR SPACE AT A COMPETITIVE PRICE;
- EXISTENCE OF INFRASTRUCTURE AND OTHER SUPPORTIVE SERVICES;
- A RESPONSIVE TAX SYSTEM;
- A SUITABLY TRAINED WORKFORCE; AND
- PUBLIC SECTOR CAPACITY TO ASSIST DEVELOPMENT.

MOST AREAS FACING DISINVESTMENT ARE LACKING AT LEAST ONE OF THESE ELEMENTS. TAX INCENTIVES ALONE ARE NOT ENOUGH TO ENCOURAGE REVITALIZATION IF OTHER NEEDS MUST BE ADDRESSED AS WELL.

IT IS A COMPLEX COMBINATION OF THESE PHYSICAL, FINANCIAL, AND LABOR COMPONENTS WHICH MAKE AN AREA ATTRACTIVE TO INVESTORS AND ENTREPRENEURS. IN ASSESSING THE POTENTIAL OF ENTERPRISE ZONES TO REVITALIZE DISTRESSED URBAN AREAS, WE MUST NOT NEGLECT THE OTHER ELEMENTS NEEDED FOR PRIVATE INVESTMENT TO OCCUR. FOR ENTERPRISE ZONES TO BE SUCCESSFUL IN IMPROVING THE INVESTMENT ENVIRONMENT, A FLEXIBLE COMBINATION OF SUITABLY TIMED LOCAL INCENTIVES AND APPROPRIATELY COORDINATED PRIVATE ACTIVITIES MUST BE PUT INTO PLACE. ALL LEVELS OF GOVERNMENT MUST NOT LOSE SIGHT OF THE FACT THAT A DELICATE BALANCE OF PUBLIC AND PRIVATE INTERESTS, UNIQUE TO EACH GIVEN AREA, MUST BE REACHED.

ISSUES WHICH S.863 ADDRESSES

THROUGHOUT DELIBERATIONS OF S.863 AND SIMILAR ZONE PROPOSALS OVER THE PAST TWO YEARS, NUMEROUS ISSUES HAVE BEEN RAISED OVER THE EXTENT AND THRUST OF THE FEDERAL INCENTIVES, THEIR COST, AND THEIR IMPACT. THIS LEGISLATION ATTEMPTS TO ADDRESS A NUMBER OF THESE ISSUES.

JOB OPPORTUNITIES. IN RESTRUCTURING THE ORIGINAL ZONE PROGRAM INCENTIVES, BOTH THIS COMMITTEE AND THE ADMINISTRATION HAVE PLACED PRINCIPAL EMPHASIS ON DIRECT JOB-GENERATING INDUCEMENTS. COMPANIES

WHICH STAND TO REALIZE THE GREATEST BENEFITS FROM EMPLOYMENT TAX CREDITS, THEREFORE, WILL BE THE LARGER AND MORE LABOR INTENSIVE BUSINESSES AND INDUSTRIES. IN ADDITION, THESE CHANGES WILL STRENGTHEN THE INCENTIVE TO INITIALLY HIRE AND TRAIN ECONOMICALLY DISADVANTAGED PERSONS:

- RAISING THE TAX CREDIT LEVEL TO 50 PERCENT OF WAGES FOR TARGETED GROUPS WILL FOCUS ATTENTION ON HIRING ECONOMICALLY DISADVANTAGED PERSONS, AND IN LARGER NUMBERS.
- EXTENDING THE QUALIFYING TIME FRAME FOR THE CREDITS TO SEVEN YEARS WILL HOPEFULLY ENCOURAGE EMPLOYEE TRAINING BY ZONE FIRMS AND HIRING OF ECONOMICALLY DISADVANTAGED PERSONS INTO CAREER LADDER POSITIONS.

IN ADDITION, THE PROPOSAL DIRECTS ATTENTION TO THE PROBLEM OF INDISCRIMINATE WORKER REPLACEMENT IN EXISTING FIRMS AT THE OUTSET OF ZONE DESIGNATION BY BASING THE WAGES SUBJECT TO THE CREDIT ON THE AMOUNT OF TOTAL COMPANY PAYROLL INCREASES WHICH HAVE OCCURRED SINCE THE YEAR BEFORE THE ENTERPRISE ZONE WAS ESTABLISHED.

MINIMIZING ABUSES. THE PROPOSED BILL TRIES TO DEAL WITH SOME OF THE CONCERNS THAT BUSINESSES WOULD USE ENTERPRISE ZONES TO LAUNDER PROFITS FROM PLANTS OUTSIDE OF THE ZONES OR MAKE THEM THE TAX HOME OF PORTABLE CAPITAL EQUIPMENT, WHILE CREATING FEW JOBS OR DOING LITTLE TO AID THE ECONOMIC UPGRADING OF A ZONE AREA. FOR INSTANCE:

- PROPERTY ON WHICH THE ADDITIONAL INVESTMENT TAX CREDIT IS CLAIMED MUST BE USED WITHIN THE ZONE FOR ITS ENTIRE DEPRECIABLE LIFE IN ORDER TO AVOID RECAPTURE OF SOME OR ALL OF THE CREDIT.
- ELIMINATING THE SUGGESTED BUSINESS INCOME TAX EXCLUSION LESSENS THE CHANCES OF ZONES BECOMING HAVENS FOR FIRM SUBSIDIARIES WHICH WOULD SERVE ONLY AS CONDUITS FOR BUSINESS INCOME AND INVENTORY.

STATE AND LOCAL INVOLVEMENT. BY BROADENING THE LOCAL CONTRIBUTION REQUIREMENT OF EARLIER PROPOSALS, THE PLAN DIRECTS ATTENTION TOWARDS THE FORMULATION OF A DEVELOPMENT STRATEGY WHICH MATCHES LOCALIZED NEEDS WITH AVAILABLE STATE AND LOCAL RESOURCES. THE ADMINISTRATION'S PROPOSAL:

- MANDATES STATE AND LOCAL COOPERATION IN DEVELOPING A WORKABLE STRATEGY FOR THE ECONOMIC REVITALIZATION OF THE ZONE AREA;
- BROADENS THE SCOPE OF STATE AND LOCAL CONTRIBUTIONS BEYOND SIMPLY OFFERING TAX RELIEF BY INVITING OTHER FORMS OF INCENTIVES AND COMMITMENTS; AND
- ENCOURAGES DIRECT PARTICIPATION OF PUBLIC AND PRIVATE NEIGHBORHOOD ORGANIZATIONS.

IN ADDITION, S.863 CONTAINS A PROVISION WHICH GRANTS RETROACTIVE ELIGIBILITY FOR EMPLOYER TAX CREDITS FOR BUSINESSES HIRING QUALIFIED WORKERS UNDER STATE ENTERPRISE ZONE LAWS, BUT BEFORE THE ONSET OF FEDERAL DESIGNATION. THIS MEANS THAT PENDING FEDERAL LEGISLATION WILL NOT BE A DETERRENT TO PRIVATE INVESTMENT CONSIDERED IN RESPONSE TO SPECIFIC STATE INCENTIVES.

ISSUES REMAINING

THE PROPOSED LEGISLATION DOES NOT ADDRESS A NUMBER OF CONCERNS WHICH THE DISCUSSIONS AND ANALYSIS OF THE CONCEPT OVER THE PAST TWO YEARS HAVE BROUGHT FORTH.

FOR INSTANCE, THE TAX CREDIT EMPHASIS MEANS THAT THE DEGREE OF BUSINESS PROFITABILITY, RATHER THAN TYPE OF ECONOMIC ACTIVITY OR FORM OF INITIAL INVESTMENT, REMAINS THE KEY FACTOR FOR FIRMS TO CONSIDER WHEN DETERMINING THE MAGNITUDE OF POTENTIAL INCENTIVES FOR THEMSELVES. THERE ARE ALSO NO ANTI-RELOCATION DISINCENTIVES TO DISCOURAGE FIRMS FROM SHIFTING EXISTING OPERATIONS FROM OTHER DISTRESSED

AREAS OR FROM LOCATIONS WITHIN THE SAME CITY. PROFITABLE FIRMS MAY CONSEQUENTLY RELOCATE TO ZONE AREAS, POTENTIALLY DISRUPTING ECONOMIES IN OTHER AREAS, TO MERELY REFOCUS EXISTING ECONOMIC ACTIVITY RATHER THAN GENERATE NEW GROWTH. CLAIMS THAT EXISTING FIRMS TEND NOT TO RELOCATE NEED TO BE REEXAMINED IN THE FACE OF THE NEW INCENTIVES PRESENT IN THE ENTERPRISE ZONE PROPOSAL. IT WOULD BE POSSIBLE TO BUILD IN SOME DISINCENTIVES TO DISCOURAGE SUCH RELOCATIONS. AN ELABORATE MONITORING SYSTEM WOULD NOT BE REQUIRED.

OTHER TOPICS WHICH THIS VERSION FAILS TO ADDRESS INCLUDE ACCESS TO CAPITAL AND DIRECT SMALL BUSINESS ASSISTANCE.

ACCESS TO CAPITAL. S.863 LACKS A MECHANISM TO SPUR SIGNIFICANT VENTURE CAPITAL ASSISTANCE FOR FIRMS LOCATING WITHIN THE ZONES. DURING DISCUSSIONS OF THE ENTERPRISE ZONE CONCEPT OVER THE PAST TWO YEARS, SEVERAL ALTERNATIVE PROVISIONS HAVE BEEN MENTIONED:

- EQUITY EXPENSING, WHICH PROVIDES ACCELERATED, ONE-YEAR TAX WRITE-OFFS FOR INVESTORS, WOULD ENCOURAGE AN INFLUX OF INVESTMENT CAPITAL TO THE ZONES. TAX EXPENDITURE IMPACTS WOULD BE MINIMIZED BY PLACING A CAP ON THE TOTAL DEDUCTION. SUCH A LIMIT COULD NOT DIMINISH THE VALUE OF THIS INCENTIVE FOR THOSE SMALL BUSINESSES MOST IN NEED OF START-UP CASH.

- EARLY DRAFTS OF ENTERPRISE ZONE LEGISLATION, INCLUDING THE ORIGINAL KEMP-GARCIA BILL, EXCLUDED FROM FEDERAL TAXATION 50 PERCENT OF ALL INTEREST INCOME EARNED ON LOANS TO ZONE BUSINESSES. THIS WOULD HAVE ESSENTIALLY CREATED A TAX SHELTER AND COULD HAVE ENCOURAGED FINANCIAL INSTITUTIONS AND INDIVIDUALS TO MAKE CAPITAL AVAILABLE IN THE ZONES. IT WOULD HAVE ALSO MADE MARGINAL LOANS, LOAN POOLS AND INTEREST RATE REDUCTIONS EASIER TO NEGOTIATE, AND PROVIDED LOCAL

ECONOMIC DEVELOPMENT PRACTITIONERS WITH A FLEXIBLE AND USEFUL TOOL. HOWEVER, THIS INCENTIVE HAS BEEN DROPPED. IT SHOULD BE RECONSIDERED.

- REFUNDABILITY OF EMPLOYER TAX CREDITS COULD PROVIDE BUSINESSES WITH A SOURCE OF MONEY WITH WHICH TO BUILD CASH FLOW AND INVEST IN CAPITAL EQUIPMENT. LIMITED REFUNDABILITY WOULD DISCOURAGE ABUSES AND MINIMIZE COSTS WHILE PROVIDING SMALL BUSINESSES WITH A RELIABLE SOURCE OF CAPITAL.

ANY OF THESE METHODS, OR SOME COMBINATION OF THEM, COULD BE PUT INTO THE LEGISLATION TO ADDRESS THE CAPITAL ISSUE. ANY SUCH PROVISION COULD BE STRUCTURED TO LIMIT THE POTENTIAL REVENUE LOSS TO THE TREASURY WITHOUT CRIPPLING ITS OBJECTIVE.

SMALL BUSINESS ASSISTANCE. WHILE IT IS CLEARLY DESIRABLE TO ATTRACT LARGE NEW INDUSTRIES OR BRANCH PLANTS TO THE ZONES, SMALL BUSINESSES ARE ALSO NEEDED IF THEY ARE TO SUCCEED IN REVITALIZING URBAN AREAS. RESEARCH INDICATES THAT SMALL BUSINESSES PROVIDE OVER ONE-THIRD OF ALL NEW JOBS GENERATED--BUT ARE THE LEADERS IN CREATING EMPLOYMENT OPPORTUNITIES IN DISTRESSED AREAS SUCH AS THOSE WHICH WOULD BE DESIGNATED AS ENTERPRISE ZONES. YET, WHILE SMALL BUSINESSES ARE OFTEN PIONEERS IN REVITALIZING DETERIORATED AREAS, MANY OF THEM WILL NOT BE ABLE TO COUNT ON A NUMBER OF THE PROPOSED INCENTIVES. TAX CREDITS FAVOR FIRMS WHICH WILL MAKE MONEY FROM THE OUTSET. IT IS QUESTIONABLE WHETHER THE PROPOSED TAX INCENTIVES CAN ACTUALLY ASSIST SMALL BUSINESS DEVELOPMENT. SMALL BUSINESSES NEED UP-FRONT CAPITAL IN THEIR EARLY YEARS DURING WHICH PROFITS ARE MINIMAL AND THE RISK OF FAILURE IS GREAT. TAX CREDITS DO LITTLE TO HELP BUSINESSES WITH NO TAX LIABILITY; CARRY FORWARD PROVISIONS APPLY MORE TO ESTABLISHED BUSINESSES. THE BILL DOES NOT ADDRESS A NUMBER OF SMALL BUSINESS CONCERNS:

- NO DIRECT JOB TRAINING ASSISTANCE IS OFFERED FOR SMALL BUSINESSES.
- NO MECHANISMS FOR DIRECT SMALL BUSINESS ASSISTANCE ARE PROVIDED; SUCH FIRMS NEED CASH, NOT TAX CREDITS.
- THE THREE TO TEN PERCENT INVESTMENT TAX CREDIT WILL NOT BE SUFFICIENT IN MANY CASES TO ATTRACT THE NECESSARY CAPITAL INVESTMENTS WHICH EXISTING SMALL BUSINESSES WILL NEED TO IMPROVE THEIR PLANTS AND GROWTH POTENTIAL SO THAT THEY CAN TAKE ADVANTAGE OF OTHER ENTERPRISE ZONE INCENTIVES.
- FEW SMALL BUSINESSES COULD BENEFIT FROM THE ASSURED AVAILABILITY OF INDUSTRIAL DEVELOPMENT BONDS (IDBs). THESE ARE ONLY AVAILABLE TO FIRMS WITH A GOOD CREDIT HISTORY. SUCH BONDS ARE USUALLY FLOATED FOR A MINIMUM OF $250,000 AND ARE GEARED TO LARGER INDUSTRIAL PROJECTS.

FINALLY, RECONDITIONING OR BUILDING INFRASTRUCTURE IN EITHER PUBLIC AREAS OR ON PRIVATE SITES, WHICH IS CRITICAL TO PRIVATE INVESTMENT, COULD BE DIFFICULT FOR CITIES TO PROVIDE IN THIS ERA OF TIGHT LOCAL BUDGETS AND REDUCED FEDERAL DEVELOPMENT ASSISTANCE.

ISSUES THAT ENTERPRISE ZONE IMPLEMENTATION RAISES

THE ADMINISTRATION HAS, THROUGH WRITTEN PLANS AS WELL AS THROUGH SPOKEPERSONS, PROVIDED SOME INDICATION OF HOW IT WOULD LIKE TO IMPLEMENT ENTERPRISE ZONE LEGISLATION SUCH AS S. 863. SUCH SUGGESTIONS INCLUDE THE DESIRABILITY OF CERTAIN LOCAL INCENTIVES AND THE AVENUES FOR LEGAL RECOURSE. THEY RAISE A NUMBER OF ISSUES WHICH NEED TO BE EXPLORED DURING LEGISLATIVE AUTHORIZATION.

INTERGOVERNMENTAL RESPONSIBILITIES. THE ADMINISTRATION CLEARLY INTENDS TO FURTHER ITS NEW FEDERALISM INITIATIVE THROUGH THE ENTERPRISE ZONE PROGRAM. CERTAINLY, IT IS DESIRABLE TO ENCOURAGE STATE

AND LOCAL COORDINATION IN DEVISING THE METHODS, TECHNIQUES, AND STRATEGIES TO ADDRESS THE ECONOMIC DEVELOPMENT NEEDS OF DISTRESSED AREAS. HOWEVER, THE ADMINISTRATION'S PLAN RAISES A NUMBER OF ISSUES THAT MAY AFFECT A JURISDICTION'S ABILITY TO COMPETE FOR ZONE DESIGNATION.

- THE STATE AND LOCAL COORDINATION NEEDED TO NOMINATE ZONE AREAS AND DEVISE THE REQUISITE PACKAGE OF INCENTIVES MAY BE DIFFICULT TO ACHIEVE IN MANY STATES. CUED REMAINS CONCERNED OVER THE REQUIRED STATE ROLE IN THE NOMINATIONS PROCESS AND IN ASSEMBLING THE PACKAGE OF NON-FEDERAL INCENTIVES. THERE IS NO QUESTION THAT STATES CAN TAKE ACTIONS AND MAKE COMMITMENTS WHICH IMPROVE THE LIKELIHOOD THAT A ZONE WILL BE SUCCESSFUL, PARTICULARLY THOSE IN RURAL OR MULTI-JURISDICTIONAL AREAS. HOWEVER, TO MANDATE SUCH INTERACTION MAY JEOPARDIZE THE PROSPECTS FOR DESIGNATION, AND APPLICATIONS AND PACKAGES, OF MANY CITIES WHICH CAN NOT OR CHOOSE NOT TO WORK WITH THEIR STATE GOVERNMENTS. THE FEDERAL GOVERNMENT SHOULD NOT IMPOSE THIS PHILOSOPHY ON THESE LEVELS OF GOVERNMENT. CITIES SHOULD BE PERMITTED THE OPTION OF GOING IT ALONE, OF COMPETING FOR DESIGNATION ON THEIR OWN MERITS.

- SHORT LEGISLATIVE SESSIONS MAY IMPEDE THEIR DEVELOPMENT. NINETEEN STATES HAVE ANNUAL LEGISLATIVE SESSIONS OF 60 DAYS OR LESS, AND SEVEN HAVE NO REGULARLY SCHEDULED SESSIONS. THIS COMPLICATES THE TIMING OF RESOLUTIONS NECESSARY FOR ZONE DESIGNATION, PARTICULARLY IN THE FIRST ROUND OF COMPETITION. IF COORDINATION OF FEDERAL ASSISTANCE SUCH AS UDAG OR CDBG IS INVOLVED, INACTION BY A LEGISLATURE COULD DERAIL THE FEDERALLY FUNDED CONTRIBUTION WHICH A LOCAL GOVERNMENT HAS GARNERED.

- THE SPECIFICS OF STATE PARTICIPATION ARE NOT PROVIDED, RAISING QUESTIONS AS TO THE EXTENT OF STATE PARTICIPATION THAT IS PRACTICALLY

REQUIRED. FOR INSTANCE, THE TYPE OF ENABLING LEGISLATION TO NOMINATE A ZONE AREA FOR DESIGNATION IS NOT CLEARLY DEFINED. GUARANTEES OR STATE AND LOCAL COMMITMENTS MAY BE DIFFICULT TO OBTAIN, AND THEIR EXTENT IS NOT SPECIFIED.

- POLITICAL DIFFERENCES OR INTRA-STATE RIVALRIES COULD ALSO HARM LOCAL EFFORTS TO GAIN STATE CONCESSIONS ON REGULATORY OR TAX ISSUES.
- LEGAL STEPS WHICH EITHER STATE OR LOCAL GOVERNMENTS COULD PURSUE IF THE OTHER RENEGES ON PROMISED INCENTIVES HAVE NOT BEEN OUTLINED. SIMILARLY, A COURSE OF RELIEF FOR BUSINESSES OR INDIVIDUALS WHO LOSE BENEFITS IF PROMISED INCENTIVES ARE NOT DELIVERED OR IN CASE OF A ZONE REVOCATION IS NOT PRESCRIBED. THE ADMINISTRATION, IN DISCUSSING ITS PLAN, NOTES THAT ANY OF THESE PERSONS OR ENTITIES WOULD HAVE THE RIGHT TO SUE IN THE EVENT THAT AN ELEMENT OF THE ZONE PACKAGE WAS NOT DELIVERED AS PROMISED.
- THE PROPOSAL IS NOT CLEAR ON HOW HOME RULE CITIES WILL EXERCISE THEIR POWERS IF STATE APPROVAL IS NEEDED FOR DEVELOPING AND GUARANTEEING ZONE INCENTIVES.

FINALLY, WHILE PARTICIPATION IN A STATE ENACTED ENTERPRISE ZONE PROGRAM WILL UNDOUBTEDLY GIVE CITIES A LEG UP IN THE ADMINISTRATIVE AND GRANTSMANSHIP SKILLS REQUIRED TO ASSEMBLE A COMPETITIVE FEDERAL ENTERPRISE ZONE APPLICATION, SUCH PARTICIPATION IN AND OF ITSELF SHOULD NOT RESULT IN SUCH CITIES COMMANDING A MORE FAVORABLE COMPETITIVE POSITION WITHIN HUD VIS-A-VIS NON-STATE ZONE CITIES. ALL OFFERED PACKAGES SHOULD BE WEIGHED EQUALLY; IT IS LIKELY THAT A NUMBER OF CITIES WILL BE ABLE TO ARRANGE LOCAL INCENTIVE PACKAGES WHICH FEATURE GREATER INCENTIVES THAN OTHER JURISDICTIONS ARE ABLE TO MUSTER UNDER THE AUSPICES OF A STATE ENTERPRISE ZONE PROGRAM.

SELECTION CRITERIA. BECAUSE THE OTHER ELIGIBILITY CRITERIA ARE LARGELY PERFUNCTORY, THE INCENTIVES AND SERVICES STATE AND LOCAL GOVERNMENTS COMMIT TO THE ENTERPRISE ZONE WILL BE THE KEY ELEMENT IN ZONE DESIGNATION. EACH JURISDICTION WILL HAVE TO SHOW THAT ITS PROPOSED INCENTIVES ADDRESS LOCAL DEVELOPMENT NEEDS AND WILL INDUCE PRIVATE INVESTMENT IN THE ZONE.

IF CERTAIN CRITERIA ARE TO BE EMPHASIZED IN THE COMPETITIVE EVALUATION FOR DESIGNATION OF ZONES, THEY NEED TO BE CLEARLY DEFINED. WHILE FLEXIBILITY IS MENTIONED AS THE GUIDING PRINCIPLE IN DEVELOPMENT LOCAL INCENTIVES, CERTAIN ASPECTS SHOULD NOT IMPLICITLY BE CONSIDERED LESS OR MORE IMPORTANT IN THE EVALUATIVE RANKINGS. COMPLETE PACKAGES WHICH ADDRESS THE TOTAL DEVELOPMENT NEEDS AND EXISTING LEVELS OF EFFORT OF A LOCALITY SHOULD BE CONSIDERED.

JOB OPPORTUNITIES FOR THE DISADVANTAGED. ALTHOUGH THE PROPOSAL HIGHLIGHTS INCREASING JOB OPPORTUNITIES FOR ECONOMICALLY DISADVANTAGED PERSONS THROUGH STRENGTHENED INCENTIVES, IT HAS REMOVED THE REQUIREMENT FROM EARLIER VERSIONS THAT THEIR EMPLOYMENT WAS A CONDITION WHICH MUST BE MET BEFORE A FIRM COULD QUALIFY FOR ANY OF THE FEDERAL ENTERPRISE ZONE BENEFITS. EARLIER PROPOSALS CALLED FOR MINIMUM PERCENTAGE THRESHOLDS OF NEW HIRES FROM THE RANKS OF THE ECONOMICALLY DISADVANTAGED, FOR BOTH NEW AND EXISTING BUSINESSES WITHIN THE ZONES. A REQUIREMENT FOR HIRING CERTAIN LEVELS OF DISADVANTAGED PERSONS WOULD BE DIFFICULT TO ADMINISTER AND ONEROUS ESPECIALLY FOR SMALL BUSINESSES. HOWEVER, EVERY EFFORT SHOULD BE MADE THROUGH FEDERAL, STATE, AND LOCAL TRAINING PROGRAMS TO PROVIDE ADEQUATE JOB OPPORTUNITIES FOR UNEMPLOYED AND UNDEREMPLOYED PERSONS IN ENTERPRISE ZONES.

OUTLOOK

AS WITH SIMILAR PROPOSALS, THE EVENTUAL IMPACT OF ENTERPRISE ZONE INCENTIVES ON REBUILDING THE ECONOMIES OR TARGETED URBAN AREAS REMAINS UNKNOWN. VARIABLES SUCH AS THE LOCAL CONTRIBUTION PACKAGE, THE EXISTING ECONOMIC, PHYSICAL, AND SOCIAL CONDITION OF THE ZONE, THE TYPES OF BUSINESSES LOCATING WITHIN THE DESIGNATED AREA, AND OTHERS WILL VARY WIDELY FROM CITY TO CITY. THUS, THE ABILITY TO PREDICT ANY GENERAL RESULTS OF ESTABLISHING ENTERPRISE ZONES IS IMPOSSIBLE. NEVERTHELESS, THE LEGISLATION COULD SPARK MORE STATE-LOCAL COOPERATION IN PINPOINTING SPECIFIC LOCAL DEVELOPMENT NEEDS AND ASSESSING THE SCOPE OF STATE AND LOCAL RESOURCES AVAILABLE FOR THAT DEVELOPMENT.

AS A FINAL POINT, CUED WOULD LIKE TO UNDERSCORE WHAT SO MANY OTHERS HAVE STATED: ENTERPRISE ZONES WILL WORK ONLY IF OTHER SUPPORTIVE ECONOMIC DEVELOPMENT TOOLS CONTINUE TO EXIST. IF RESOURCES FOR SUCH PROGRAMS AS CDBG, UDAG, EDA, AND JOB TRAINING ARE REMOVED, THE ENTERPRISE ZONE CONCEPT WILL FAIL. ENTERPRISE ZONES BY THEMSELVES WILL NOT BE ABLE TO REVITALIZE DISTRESSED AREAS.

National Federation Independent Unions

SUITE 301 • 1111 19TH STREET N. W. WASHINGTON, D.C. 20036 • 202-659-1490

Testimony for Francis Chiappardi, President of the National Federation of Independent Unions

FRANCIS J. CHIAPPARDI
National President

Suite 301
1111 19th Street, N.W.
Washington, D.C. 20036
Phone: (202) 659-1490

FRED W. TITTLE
Executive Secretary-Treasurer

263 Main Street
Brookville, Pa. 15825
Phone: (814) 849-2325

Executive Vice Presidents

Eastern Region
MICHAEL TIRRELL
1708 Washington Blvd.
Easton, Pa. 18042
Phone: (215) 252-7553

Southern Region
E. D. Mitchell
P.O. Box 2701
Baton Rouge, La. 70806
Phone: (504) 927-0426

Northern Region
RAYMOND JACKSON
Box 85
Tecumseh, Michigan 49286
Phone: (517) 423-4040

Central Region
O. ROBERT DICKSON
1281 Walnut Drive
Zanesville, Ohio 43701
Phone: (614) 453-8343

Western Region
RILEY SLOAN
P.O. Box 9227
Fort Worth, Texas 76107
Phone: (817) 332-9004

ADMINISTRATIVE OFFICE

FRED M. FEDER
General Counsel

1188 South 11th Street
Philadelphia, Pa. 19147
Phone: (215) 336-3300

I am Francis Chiappardi, President of the National Federation of Independent Unions. I appreciate this opportunity to introduce testimony into the written record on behalf of our 70,000 members and 38 affiliated unions.

The National Federation of Independent Unions strongly supports S.863, The Enterprise Zone Employment and Development Act of 1983. We believe that enterprise zones, as envisioned in the draft legislation, constitute a promising experiment that, even as Congress deliberates, has become more than an experiment. Twenty-nine states have either established enterprise zones, are planning to establish zones, or have legislation pending to establish zones. The political experience in these states to date suggests widely shared enthusiasm for the concept. In Washington enterprise zones are sometimes labeled by their opponents as an Administration program, even though Congressman Robert Garcia, (D-NY) is one of the fathers of the Federal legislation and many Democrats have co-sponsored it. In states such as Louisiana, Texas Hawaii, New York, New Jersey, Oklahoma, and Arkansas, however, state enterprise zone legislation enacted or now pending has been prompted mostly by Democrats. The enterprise zone concept has drawn such support because it is neither liberal, conservative, Republican or Democrat. It has deeper roots in such broadly American values as community and free enterprise. And it offers something to the depressed areas of our country that we all can support -- jobs.

I have been saddened that my brothers in the labor movement are turning this bill - that I see as a positive step - into a political football. It appears to me that the testimony others in the labor movement have offered reflects a fundamental ignorance concerning the proposal. Let me give you a couple of examples.

> It is charged that the proposed enterprise zone program will reduce public revenues - but zones will be placed in areas that are not now generating much in public revenues. Moreover, zone incentives in the Federal bill require that an area become more prosperous, that new business activity take place before taxes are reduced.

The reductions, then, are not in existing taxes but in future taxes on growth. Confusion is particularly evident on the capital gains tax issue. It is charged that the elimination of the capital gains tax will prompt businesses already in zones to sell out. Areas such as those that would receive enterprise zone designations are declining areas, where businesses have been taking capital losses. To benefit from this provision most businesses in such areas would have to experience a dramatic turn in fate, just the sort of turn that would signal the success of this program. Furthermore, for every seller, there must be a buyer. Those who bought enterprise zone businesses would have to see an improvement in business to take advantage of the capital gains elimination.

It is charged that the zones would draw businesses that would take advantage of the tax breaks and move on. Studies have shown that for a large company the personnel costs of moving a plant -- that is, severance pay, the training of new employees at new sites, costs over and above moving machinery, acquiring new facilities and the like -- amount to as much as $70,000 per worker. This program may be powerful, but it is not so powerful as to justify incurring that kind of expense.

It is said by others in the labor movement that the bill will induce states to rollback public health and safety regulations. We have looked at what states and cities are already doing in this area -- 14 states have already or will soon be setting up their own enterprise zones; 15 others have legislation pending that would set up zones whether or not Congress acts. We have yet to see any evidence, any evidence at all, that cities participating in these state programs are acting to endanger public health or safety. What they are doing most dramatically is moving to faster processing of licenses and applications. One stop permitting is being widely employed. One city has begun to require that, when several boards must pass on one project, the boards meet jointly in one night rather than spreading separate meetings over several weeks or months. I would say that actions like that promote the most important key to public health and safety - jobs.

As I said before, we at the NFIU believe that this package is a strong, balanced, promising experiment in community revitalization. Who would doubt that most programs to combat poverty in the last fifteen years have to a great measure failed. Those programs created ever greater dependency on the government rather than the declining dependency that we were told they would produce when they were introduced. Yet the critics of enterprise zones want to have more, much more of the same failed public works and spending programs that have got us where we are today. It is almost as if they want to maintain the dependency of poor blacks and Hispanics and others, as if they regarded keeping these people out of the labor force and dependent on the government as a way of maintaining wage rates. Well, if that's their view, the NFIU respectfully disagrees. We believe that this army of the permanently unemployed threatens social peace in our nation's communities and acts as a drag on the capacity of our members to earn more money. My membership believes that the enterprise zone program will be good for them. It will create jobs where there are not now jobs; it will create new jobs. Those new jobs will mean more people will have more money to spend, and when they spend it, that will create jobs. That is our belief. We urge the Congress to test this program, to see if that expectation is correct. We urge the Congress to try, in this limited way, this new approach to some very serious national problems.

NATIONAL TAXPAYERS UNION

A NONPARTISAN, NONPROFIT ORGANIZATION DEDICATED TO THE PUBLIC INTEREST

325 PENNSYLVANIA AVENUE, SOUTHEAST
WASHINGTON, DISTRICT OF COLUMBIA 20003
TELEPHONE: AREA CODE (202) 543-1300

Statement by
David L. Keating, Executive Vice President
National Taxpayers Union
on
Proposed Legislation to Establish Enterprise Zones
for submission to the
Committee on Finance
United States Senate

April 22, 1983

The National Taxpayers Union, representing more than 120,000 members in all 50 states who are concerned with reducing government taxes and spending, fully supports the concept of enterprise zones and endorses S.863 and S.98 introduced by Senator Boschwitz.

Enterprise zones present a unique opportunity to test and demonstrate the effect of reduced government intervention. The enterprise zone concept recognizes that government itself can be a cause of urban blight. Government taxation and regulations have frustrated the private enterprises that would otherwise have been developed.

As introduced, S.863 is an excellent bill. It strikes a good balance between federal, state and local governments by calling for reduced federal taxes and regulations, while encouraging state and local governments to reduce their taxes and regulations. We are especially pleased to see that the bill proposes no federal appropriations. S.863 permits enough zones to be established to realistically assess the enterprise zone concept, while assuring that the zones that are established will be backed by a strong local commitment.

We would urge the committee to seriously consider including equity expensing in any enterprise zone bill. Under this provision, contained in S.98, an investor would be allowed to treat investments in an enterprise zone business much like the tax treatment given to individual retirement accounts. The amount of the investment in the enterprise zone business could be written off the investor's income. Tax would only be paid once the investor's stock in the business is sold. Protections are written into the proposal to prevent "paper" businesses from being set up just to obtain tax benefits without providing any economic benefit to the enterprise zone.

Revitalization of an urban area, of course, requires changes in social, as well as economic factors. Such factors as the crime rate and the physical condition of the neighborhood can be a deterrent to renewal. Establishment of neighborhood associations within the zones could help solve these problems. Associations which have successfully activated local residents could be deeded government-owned vacant land inside the zone, thus giving residents an equity stake in the area. As the neighborhood improves, the value of this equity would rise and its lease value would rise. This would give the residents a direct financial incentive to improve conditions in their neighborhood. These associations could provide services to the area such as housing, block patrols designed to reduce crime, park upkeep and street lighting. This plan could also benefit city governments, by reducing the costs of various municipal services to an area.

Members of the association would also be protected against displacement. The increased income generated from the rising lease values of their land grant and the increased availability of jobs should enable residents to easily afford the rising housing costs in an enterprise zone area.

Because of our support for these types of neighborhood associations, we urge the committee to include a General Stock Ownership Corporation (GSOC) plan in any enterprise zone bill it drafts, such as the one contained in S.634 by Senator Hart. GSOCs would help accelerate development of these types of neighborhood associations and businesses. The residents of the enterprise zones would have a direct incentive to help make them work because they would profit from a successful enterprise zone development. The GSOC proposal could prove one of the most important incentives to a successful enterprise zone experiment.

An expanded Employee Stock Ownership Program (ESOP) could also encourage greater employee participation and commitment to jobs in the enterprise zone areas, jobs which may call for special commitment to make the business succeed.

We caution the Committee not to add any provision in the bill to increase government regulation or require that enterprise zone businesses hire or train a certain proportion of the population that is deemed to bw disadvantaged. Increased regulation would run contrary to the spirit and the concept of the enterprise zone, seriously harming its chances for success.

Since the end of the second World War, billions of taxpayers' dollars have been funneled into a variety of programs designed to help America's decaying inner cities. From the urban renewal projects of the 1950s and 1960s, to C.E.T.A. projects of the 1970s, these programs have uniformly proved to be failures. Business continued to flee the central cities, unemployment has risen, and the crime rate remains high. The traditional answer to the failure of these government programs has been a call for more and bigger government programs, despite the evidence that they just don't work. It's time to try a new approach. By reducing government taxes and regulations through enterprise zone legislation, we can create new hope for residents of these depressed regions.

We believe that adoption of a comprehensive urban enterprise zone act would provide the best opportunity in years to demonstrate the benefits of a relatively free enterprise, under the toughest conditions.

We hope the Committee and Congress will soon pass a measure to implement and test the concept of enterprise zones.

Office of the Governor
La Fortaleza
San Juan, Puerto Rico 00901

May 3, 1983

Mr. Roderick A. De Arment
Deputy Chief Counsel
Senate Committee on Finance
221 Senate Dirksen Building
Washington, D. C. 20510

Dear Mr. De Arment:

Enclosed please find my testimony, on the proposed Enterprise Zone Tax Act (S. 98). The use of tax incentives to stimulate private investment has been a part of the economic development program of Puerto Rico since the late 1940's. The Enterprise Zone legislation before you is a comprehensive and sensible approach towards the problem of urban blight and unemployment.

While we support the Enterprise Zone Bill in concept, if the bill is adopted as presently drafted, it could affect the economy of Puerto Rico. The increased tax benefits to be offered by the proposed legislation will constitute a disincentive to U.S. corporations, (possessions corporations) which operate businesses on the Island. To avoid these adverse effects on our economic growth, we are proposing specific amendments (enclosed) that would allow U.S. companies operating businesses on the Island the needed flexibility to maintain operations and benefit from the program.

I urge you, and all the members of the Committee to adopt our proposed amendments so that the intention of extending the benefits of the bill to Puerto Rico can truly be accomplished.

Cordially,

Carlos Romero Barceló

Carlos Romero-Barceló

Enclosure

STATEMENT SUBMITTED FOR THE RECORD
BY THE
HONORABLE CARLOS ROMERO-BARCELO
GOVERNOR OF PUERTO RICO

ON CURRENT
ENTERPRISE ZONE LEGISLATION
BEFORE THE
UNITED STATES SENATE
COMMITTEE ON FINANCE

May 6, 1983
Washington, D.C.

CHAIRMAN DOLE AND MEMBERS OF THE COMMITTEE:

AS GOVERNOR OF PUERTO RICO, I WISH TO PRESENT OUR VIEWS CONCERNING THE PROPOSED ENTERPRISE ZONE LEGISLATION FOR THE RECORD.

DURING LAST YEAR'S HEARINGS BEFORE THE SENATE SUBCOMMITTEE ON SAVINGS, PENSIONS AND INVESTMENT POLICY I PRESENTED SIMILAR TESTIMONY FOR THE RECORD. I WILL REITERATE THOSE VIEWS.

THE USE OF TAX INCENTIVES TO STIMULATE PRIVATE INVESTMENT IS NOT A NEW IDEA. THIS APPROACH HAS BEEN STIMULATING PUERTO RICO'S ECONOMIC GROWTH SINCE THE EARLY 1950'S. THIS FOR TWO REASONS: THE GOVERNMENT BY ITSELF COULD NOT FINANCE THE INVESTMENT REQUIRED FOR RAPID DEVELOPMENT ON THE ISLAND, AND AGRICULTURE ALONE WAS NOT CAPABLE OF SUSTAINING THE ECONOMY. THUS, AN INDUSTRIAL INCENTIVES PROGRAM STRUCTURED AROUND A TAX INCENTIVES PROGRAM WAS ADOPTED TO DEVELOP THE ISLAND FROM AN AGRICULTURALLY ORIENTED ECONOMY TO A MODERN INDUSTRIALIZED ONE. THIS GROWTH AND DEVELOPMENT HAS HAD UNQUESTIONABLE POSITIVE AND NEGATIVE EFFECTS ON OUR SOCIETY. HOWEVER, WE BELIEVE THAT OVERALL, THE POSITIVE EFFECTS OUTWEIGH THE NEGATIVE ONES. HAD THE CONCEPT NOT BEEN IMPLEMENTED, PUERTO RICO WOULD HAVE DEVELOPED ECONOMICALLY TO A FAR LESSER EXTENT. AS A TERRITORY, PUERTO RICO NEEDS TAX INCENTIVES TO PROVIDE FOR FASTER RECUPERATION OF INVESTMENT THAN WOULD BE REQUIRED IF PUERTO RICO WERE A STATE.

THE INDUSTRIAL INCENTIVES PROGRAM CONTRIBUTED TO OUR ECONOMIC GROWTH AND DEVELOPMENT, BUT WAS NOT THE ONLY FACTOR. FEDERAL ASSISTANCE PROGRAMS ADDRESSING DEVELOPMENT OF THE BUSINESS, SOCIAL AND ECONOMIC SECTORS HAVE ALSO CONTRIBUTED TO THE

WELL-BEING OF THE 3.2 MILLION AMERICAN CITIZENS ON THE ISLAND. IN ADDITION, THE ACHIEVEMENTS OF OUR LOCAL ENTREPRENEURS IN THE FREE MARKET SYSTEM HAVE ALSO CONTRIBUTED TOWARDS DEVELOPING OUR ECONOMY. LOCAL GOVERNMENT EFFORTS HAVE ALSO CONTRIBUTED, RAISING A PER CAPITA INCOME THAT IN 1950 WAS $296 TO WHAT WAS IN 1982 $3,918. I WISH TO STRESS, HOWEVER, THAT PUERTO RICO'S PRESENT PER CAPITA INCOME IS STILL ONLY 57 PERCENT OF THE POOREST STATE IN THE NATION. MUCH MORE MUST BE DONE IN ORDER TO CONTINUE OUR GROWTH AND DEVELOPMENT.

THE ENTERPRISE ZONE LEGISLATION BEFORE YOU ADDRESSES THE NEED FOR STIMULATION OF LOCAL ECONOMIES THROUGH TAX AND REGULATORY RELIEF, STATE-LOCAL PARTICIPATION AND COMMUNITY INVOLVEMENT. THIS IS A COMPREHENSIVE AND SENSIBLE APPROACH TOWARDS THE PROBLEMS OF URBAN BLIGHT AND UNEMPLOYMENT.

TAX AND REGULATORY RELIEF SPURRED OUR ECONOMY AND ASSISTED THE DEVELOPMENT PROCESS. FEDERAL, STATE AND LOCAL PRESENCE, COUPLED WITH THE CONTINUED SUPPORT OF THE COMMUNITY AND THE PRIVATE SECTOR'S PARTICIPATION, IS IMPERATIVE IF AN ENTERPRISE ZONE IS GOING TO ACHIEVE ITS STATED GOALS. WE BELIEVE THAT ALL OF THESE FORCES TOGETHER CAN ACHIEVE MAXIMUM RESULTS. THE FEDERAL ROLE IS CRUCIAL, HOWEVER, ENTERPRISE ZONES CANNOT BE CONSIDERED A SUBSTITUTE FOR ALREADY ESTABLISHED AND PROVEN FEDERAL PROGRAMS THAT HAVE BEEN A CORNERSTONE FOR INFRASTRUCTURE DEVELOPMENT, HOUSING REHABILITATION AND CONSTRUCTION, JOB TRAINING, EDUCATION AND ASSISTANCE IN DEVELOPMENT OF SMALL BUSINESS. WE SHOULD HOPE THAT VARIOUS FEDERAL PROGRAMS SUCH AS THE URBAN DEVELOPMENT ACTION GRANTS, COMMUNITY DEVELOPMENT BLOCK GRANTS, EDUCATION AND TRAINING PROGRAMS, AND THE DEVELOPMENTAL PROGRAMS OF THE ECONOMIC DEVELOPMENT ADMINISTRATION BE UTILIZED TO THEIR MAXIMUM POTENTIAL TOGETHER WITH THE ENTERPRISE ZONE CONCEPT.

PUERTO RICO IS CURRENTLY IN THE MIDST OF THE EFFECTS OF THE SEVERE ECONOMIC RECESSION FROM WHICH THE REST OF THE NATION IS BEGINNING TO RECOVER. THE ESTABLISHMENT OF ENTERPRISE ZONES COULD SERVE TO RELIEVE THE UNEMPLOYMENT PROBLEMS EXPERIENCED IN SOME OF THE MOST NEEDY AREAS OF THIS COUNTRY. I AM PARTICULARLY CONCERNED ABOUT THE SPIRALING UNEMPLOYMENT RATE GRIPPING THIS NATION AND THE ISLAND. WHERE ONCE WE WERE ABLE TO LOWER AN UNEMPLOYMENT RATE WHICH I INHERITED AT 22 PERCENT DOWN TO 16.1 PERCENT, WE HAVE NOW SURPASSED THAT SAME 22 PERCENT LEVEL OF SEVEN YEARS AGO, AND WE ARE CURRENTLY AT A 24.1 PERCENT. IN ORDER TO INSURE THE PARTICIPATION OF THOSE AREAS DEMONSTRATING SEVERE UNEMPLOYMENT PROBLEMS, I WISH TO PROPOSE THAT THE LEGISLATION'S PROVISIONS FOR ELIGIBILITY CRITERIA INCLUDE A TRIGGER MECHANISM THAT AUTOMATICALLY ASSIGNS PRIORITY DESIGNATION TO THOSE AREAS EXPERIENCING AN UNEMPLOYMENT RATE EQUAL TO TWO TIMES THE NATIONAL AVERAGE. THE ESTABLISHMENT OF ENTERPRISE ZONES IN THESE AREAS WOULD ASSURE THE CONCEPT'S ADVANTAGES TO THOSE AREAS OF THE COUNTRY THAT WOULD BENEFIT THE MOST FROM ZONE DESIGNATION BY STIMULATING AREA INVESTMENTS, DEVELOPMENT AND CURTAILING MIGRATION TRENDS CAUSED BY THE SUDDEN LOSS OF JOBS AND LACK OF FORESEABLE FUTURE EMPLOYMENT IN THE AREA.

AS STATED PREVIOUSLY, AND IN MY PREVIOUS TESTIMONY, PUERTO RICO HAS BEEN MAKING USE OF A CONCEPT SIMILAR TO THE ENTERPRISE ZONE INITIATIVE SINCE THE EARLY 1950'S.

IF THE BILL IS ADOPTED AS PRESENTLY DRAFTED, IT WOULD AFFECT ADVERSELY THE ECONOMY OF PUERTO RICO. THE INCREASED TAX BENEFITS TO BE OFFERED BY THE BILL TO MAINLAND COMPANIES WILL PROVIDE COMPETITION WITH THE U.S. TAX INCENTIVES HISTORICALLY OFFERED TO CERTAIN U.S. CORPORATIONS, POSSESSIONS CORPORATIONS, WHICH OPERATE BUSINESSES ON THE ISLAND.

PASSAGE OF THE ECONOMIC RECOVERY TAX ACT OF 1981 HAS ALREADY REDUCED THE ATTRACTIVENESS OF THIS LONG-STANDING TAX INCENTIVE FOR INVESTMENT IN PUERTO RICO. THE ACCELERATED COST RECOVERY SYSTEM, ENACTED AS PART OF "ERTA" TO PROVIDE INVESTMENT STIMULUS TO U.S. BUSINESSES, HAS PUT DOMESTIC CORPORATIONS WHICH CONDUCT BUSINESS IN PUERTO RICO AT A COMPETITIVE DISADVANTAGE, SINCE THE "ACRS" PROVISIONS, LIKE THE INVESTMENT TAX CREDIT, DO NOT APPLY TO PROPERTY OWNED OR USED BY POSSESSIONS CORPORATIONS.

THE ENTERPRISE ZONE BILL COULD FURTHER REDUCE THE RELATIVE ATTRACTIVENESS OF OPERATING ON THE ISLAND THROUGH A POSSESSIONS CORPORATION.

AS THE DEPUTY ASSISTANT SECRETARY FOR TAX ANALYSIS, J. GREGORY BALLENTINE, SAID IN HIS TESTIMONY BEFORE THE HOUSE WAYS AND MEANS COMMITTEE OF THE CARIBBEAN BASIN ECONOMIC RECOVERY ACT:

> "THE PASSAGE OF THE ECONOMIC RECOVERY ACT OF 1981 (ERTA), HOWEVER, SUBSTANTIALLY, BUT UNINTENTIONALLY, REDUCED THE EFFECTIVENESS OF THESE INCENTIVES. FURTHER, MAKING THE INVESTMENT TAX CREDIT AVAILABLE TO INVESTMENT IN QUALIFYING CARIBBEAN BASIN, POSSIBLY TO THE DETRIMENT OF PUERTO RICO..."

THIS RECOGNITION OF THE NEED TO PRESERVE THE RELATIVE BALANCE OF TAX INCENTIVES PROVIDED TO U.S. CORPORATIONS OPERATING IN PUERTO RICO UNDERSCORES THE IMPORTANCE OF AMELIORATING ANY POSSIBLE ADVERSE EFFECT OF THE ENTERPRISE ZONE BILL ON THE ECONOMY OF PUERTO RICO. ADOPTION OF THIS BILL WITHOUT SOME PROVISION DIRECTLY RELATED TO OUR SITUATION WOULD BE DETRIMENTAL TO OUR CONTINUED ECONOMIC DEVELOPMENT AND WOULD BE CONTRARY TO THE OBJECTIVE OF THE ADMINISTRATION TO ASSIST DEVELOPMENT OF THE WHOLE CARIBBEAN AREA, WITH THE HELP OF PUERTO RICO.

THESE OBJECTIVES SHOULD NOT, AND NEED NOT, BE LOST IN DEALING WITH THE NATION'S URBAN PROBLEMS. TO AVOID ADVERSE EFFECTS ON OUR ECONOMIC GROWTH, WE SUPPORT THE SUGGESTIONS OF THE UNITED STATES TREASURY DEPARTMENT THAT CERTAIN TAX BENEFITS PROPOSED IN THE ENTERPRISE ZONE TAX ACT OF 1982 BE PASSED-THROUGH TO CERTAIN TAX U.S. CORPORATIONS OWNING 80 PERCENT OR MORE OF THE STOCK OF A POSSESSIONS CORPORATION. THIS WOULD ALLOW U.S. COMPANIES OPERATING BUSINESSES ON THE ISLAND THE NEEDED FLEXIBILITY TO MAINTAIN OPERATIONS AND BENEFIT FROM THE PROGRAM.

CONGRESSMAN ROBERT GARCIA, IN TESTIMONY PRESENTED BEFORE YOUR COMMITTEE ON APRIL 22, 1983, ALLUDED TO THE NEED TO FURTHER IMPROVE THE ADMINISTRATION'S ENTERPRISE ZONE BILL BY INCLUDING SOME KIND OF PASS-THROUGH MECHANISM FOR PUERTO RICO AND THE VIRGIN ISLANDS BECAUSE OF OUR UNIQUE TAX SYSTEMS.

I HAVE ATTACHED LANGUAGE TO IMPLEMENT CHANGES IN THE ENTERPRISE ZONE TAX ACT WHICH WE FEEL ARE NECESSARY TO AVOID AN ADVERSE EFFECT ON THE PUERTO RICAN ECONOMY. THIS LANGUAGE IS DRAWN FROM THE ADMINISTRATION'S CARIBBEAN BASIN ECONOMIC

RECOVERY ACT PROPOSED AS H.R. 5900 AND S. 2237 DURING THE 97TH CONGRESS.

THE ROLE OF THE SMALL BUSINESS SECTOR IS OF UTMOST IMPORTANCE FOR THE SUCCESS OF ANY AREA DESIGNATED AS AN ENTERPRISE ZONE. IN PUERTO RICO WE HAVE OVER 67,000 SMALL BUSINESSES, MOSTLY RETAIL AND SERVICES THAT PROVIDE EMPLOYMENT TO OVER 250,000 EMPLOYEES. STIMULATION OF THIS SECTOR OF THE ECONOMY IS ESSENTIAL. WE FEEL THAT ALTHOUGH TAX AND REGULATORY RELIEF IS IMPORTANT, IT MUST BE COUPLED WITH INCENTIVES DIRECTED TOWARD FORMULATION OF VENTURE CAPITAL FOR SMALL BUSINESS CREATION, DEVELOPMENT AND EXPANSION. WE VIEW CREDITS AGAINST BUSINESS TAXES AS FUNDAMENTAL, BUT CONSIDER THIS INCENTIVE ALONE AS INADEQUATE FOR FORMULATION OF A SMALL BUSINESS' MUCH NEEDED START-UP CAPITAL. THE INCENTIVES TO INVESTORS CONCEPT COULD BE USED TO HELP PROVIDE CAPITAL FOR NEWLY CREATED FIRMS.

DUE TO THE NATURE AND SCOPE OF ECONOMIC IMPACT, ENTERPRISE ZONES MAY ENHANCE A GIVEN STATE'S OVERALL ECONOMIC DEVELOPMENT. WE BELIEVE THAT STATE NOMINATION PROCEDURES ASSURE GREATER INVOLVEMENT TO ALL CITIZENS OF A STATE, AND THAT THE STATE SHOULD HAVE THE FINAL DETERMINATION AS TO WHERE ZONE DESIGNATION SHOULD BE NOMINATED.

IN CONCLUSION, WE BELIEVE THE IMPLEMENTATION OF THE ENTERPRISE ZONE CONCEPT IS A VITAL AND NECESSARY STEP TOWARDS REVITALIZATION OF THE DEPRESSED AREAS OF THIS NATION. PUERTO RICO'S RECORD AND EXPERIENCE HAS DEMONSTRATED THE POTENTIAL FOR GROWTH AND DEVELOPMENT WITHIN A ZONE. TAX AND REGULATORY RELIEF, HOWEVER, IS NOT THE ONLY ANSWER. THE CONTINUATION OF PROVEN

FEDERAL ECONOMIC ASSISTANCE, DEVELOPMENT AND TRAINING PROGRAMS IN THE ZONES IS NECESSARY FOR OVERALL SUCCESS.

IN ORDER TO AMELIORATE THE PROGRAM'S IMPACT ON PUERTO RICO'S ALREADY ESTABLISHED TAX RELIEF PACKAGE, WE STRONGLY URGE THAT THE FINAL LEGISLATION INCLUDE LANGUAGE THAT PROMOTES OUR CONTINUED ECONOMIC GROWTH BY PASSING THROUGH THE INVESTMENT TAX CREDITS PROPOSED TO THE PARENT COMPANIES OF OPERATING FIRMS IN PUERTO RICO.

SMALL BUSINESS SHOULD RECEIVE AS MUCH ASSISTANCE AS POSSIBLE, PARTICULARLY IN OFFERING INCENTIVES TO INVESTORS IN ORDER TO CREATE CAPITAL FORMATION.

STATE GOVERNMENT SHOULD HAVE THE LEAD ROLE IN THE DESIGNATION PROCESS IN ORDER TO INSURE A POSITIVE OVERALL ECONOMIC DEVELOPMENT STRATEGY WITHIN THE STATES.

WE LOOK FORWARD TOWARDS WORKING WITH THE MEMBERS AND STAFF OF THIS COMMITTEE IN ORDER TO CREATE THE TYPE OF ENTERPRISE ZONE CONCEPT THAT BENEFITS ALL STATES AND TERRITORIES, AND PARTICULARLY HELPS PROVIDE JOBS FOR THOSE THAT NEED THEM.

Proposed Amendment to S. 98

Add the following new subtitle immediately after Subtitle F at page 57:

Subtitle G — Pass-through of Certain Tax Attributes to Certain Shareholders of Domestic Corporations under Section 936 —

SEC. 252. SECTION 936 CORPORATIONS

(a) IN GENERAL.—Section 936 (relating to Puerto Rico and possession tax credit) is amended by adding at the end thereof the following new subsection:

"(i) PASSTHROUGH OF CERTAIN TAX ATTRIBUTES.—

"(1) IN GENERAL.—If a corporation with respect to which an election provided in subsection (a) is in effect for the taxable year (hereinafter in this subsection referred to as the 'electing corporation') would be a member of an affiliated group under the rules of section 1504(a) (without regard to section 1504(b)(4)), then a corporation which would be a member of such affiliated group and which owns common stock of the electing corporation shall be allowed to take into account its pro rata share of—

"(A)(i) the qualified increased employment expenditures and the economically disadvantaged credit amount (as such terms are defined in section 44I) of the electing corporation in computing its credit under section 44I, and

"(ii) the qualified wages (as defined in such section) of the electing corporation in computing its trade or business expenses under section 162; and

"(B) the amount determined under section 38, and the amount determined under section 168, with respect to enterprise zone property (within the meaning of section 48(r)), without regard to section 48(a)(2)(A).

A corporation with respect to which an election provided in subsection (a) is in effect for the taxable year shall not be allowed a credit under section 44I or 38 or a deduction under section 162 or 168 if one or more of the shareholders of such corporation qualify for the benefits of this paragraph.

"(2) REGULATIONS.--The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this subsection."

(b) EFFECTIVE DATE.--The amendment made by this section shall apply to taxable years ending after December 31, 1983.

Collins Development Corporation
43 Lindstrom Road
Stamford, Connecticut 06902
(203) 357-0123

Arthur Collins President
James B. Harvie III Vice President
Ira G. Kaplan Vice President - Finance
James A. Manzi, Jr. General Counsel

Mr. Roderick DeArment, Chief Counsel
Senate Finance Committee
United States Senate
SD 221
Washington, D. C. 20510

RE: Norwalk Enterprise Zone, Norwalk, Connecticut;
Federal Enterprise Zone Incentives to Commercial
Development

4 May 1983

Dear Mr. DeArment:

I regret that time did not permit Mr. Michael Lyons, Chairman of the Norwalk (Connecticut) Common Council Planning Committee, and myself to participate in the Senate Finance Committee Hearing on Federal Enterprise Zone legislation, held on 22 April 1983. State Enterprise Zone legislation has played a decisive role in our $10 million revitalization effort in the development of commercial and residential space in South Norwalk's Enterprise Zone. However, our experience has exemplieied the necessity of Federal support to attract significant levels of private investment to depressed Norwalk, and similar marginal areas across the Nation. Such key incentives would be provided under Federal Enterprise Zone legislation, now before the Congress.

The South Norwalk Revitalization Project is a $10 million commercial and residential development, involving the rehibilitation of 15 structures in the area's National Historic District. Located within the Norwalk Enterprise Zone, the Project serves as a catalyst for the overall renewal of the Enterprise Zone district. Initiated in 1981, the program calls for approximately 50,000 square feet of commercial space, and 105 residential condominiums. The condominiums, designed for middle-income purchasers, fill a significant gap in the region's housing market. To date, with only 30% of construction completed, almost 60% of the residential units have been sold. Slated for completion in 1984, the Project depends on a sensitively -balanced financing program. Funding has been provided by both public and private sources, including UDAGs, CDBGs, a Connecticut Department of Housing Grant, a Connecticut Department of Economic Development Grant, as well as by six area banks. The Project is also eligible for the 25% Investment Tax Credit for the rehabilitation of Certified historic structures, under 1981 ERTA.

As described below, tax and other incentives provided under State Enterprise Zone legislation are integral to the viability of our Revitalization effort:

- A strong factor in the decision to undertake the South Norwalk Project was the City's "Phased Increase Assessment Program", a tax abatement on local property taxes instituted under State Enterprise Zone legislation. As many of the buildings now undergoing revitalization were formerly abandoned and/or condemned, values of improved properties will soar to a level disproportionate to the current, depressed local economy. Therefore, the Phased Increase Assessment Program is a needed mechanism to attract middle-income purchasers and merchants who are necessary for the restoration of a healthy socio-economic base to South Norwalk.
- Under Enterprise Zone legislation, the City enacted special "Design District" zoning for the Revitalization Project area. The zoning relaxed requirements for parking, setbacks, and other related items. Without this deregulation, the Historic District could not be renewed to the density required for Project viability, and, more importantly, generation of long-term economic support for the neighborhood.
- In addition to tax and regulatory issues, the City has recognized the importance of eliminating certain barriers to investment and job creation within the Norwalk Enterprise Zone, namely, reduction of crime, restoration of infrastructure, and development of job skills within the local labor force. Collins Development has contributed funds towards a Community

Blockwatch program in the Historic District. The Blockwatch will be initiated in the next several months, as residential units are sold and commercial space is rented. Also, the Corporation is working with Norwalk Economic Opportunity Now Inc. (NEON), the local anti-poverty agency, to establish a summer program for hiring local minority youth. Such community participation is key to the turnaround of South Norwalk. The City has made key infrastructure improvements to the Project area, a $2 million effort involving streetscape revitalization, rejuvination and sinking of utility lines, and the construction of the new 282-car Haviland Street Parking Deck, slated for completion this fall.

As exemplified above, Connecticut Enterprise Zone legislation has contributed significantly to the success of the South Norwalk Revitalization Project. However, in today's economic climate, the Project would not have been feasible without Federal Grants and tax credits now in place. The UDAG and CDBG construction loans clearly provide the "means to an end". And, in particular, the 25% ITC for Certified historic structures has not only encouraged development investment, but will regenerate a healthy socio-economic base to South Norwalk by attracting qualified middle-income buryers to support local commerce. Therefore, comparatively speaking, existing Federal incentives for commercial and residential development in this Project outweigh those provided under State Enterprise Zone legislation. They remain necessary for the creation of an economic catalyst in a marginal area. As can be expected, the intricate financial package prepared for our work in the Enterprise Zone could not typically be structures for development in greater South Norwalk, or the majority of depressed communities, i.e. qualification criteria could not be met, such as certified historic structures, critical masses not acquired, and the reduction of Federal funding bases under Reaganomics. Thus, Federal Enterprise Zone legislation will prove critical to directing private investment into decaying areas throughout the United States.

For commercial/residential development, the proposed 10% investment credit for rehabilitation or new construction within an Enterprise Zone is of utmost importance to promoting investment in a decayed area. It is my understanding that this is in addition to investment tax credits provided under the 1981 Economic Tax Recovery Act. Like the 25% ITC, this mechanism will pump funds back into the local economy. Secondly, the elimination of capital gains taxes on investment in an Enterprise Zone provides incentive for increased levels of private investment. Also, proposed Federal legislation calls for expensing of investment in Enterprise Zone businesses. Availability of "up front" monies will attract viable concerns to the community, which, again, will restore economic stability.

Thank you, Mr. DeArment, for this opportunity to voice my views on the Norwalk State Enterprise Zone, and the enormous impact Federal Enterprise Zone legislation will have on the renewal of marginal areas such as South Norwalk, Connecticut. I urge you to act promptly on Federal Enterprise Zone legislation.

Respectfully Submitted,

Arthur Collins, President
Collins Development Corporation

AC/al

cc: Janice Hannert, Norwalk Redevelopment Agency

STATEMENT OF
THE NATIONAL ASSOCIATION OF HOME BUILDERS (NAHB)
before the
COMMITTEE ON FINANCE
UNITED STATES SENATE
on
ENTERPRISE ZONE LEGISLATION

APRIL 22, 1983

Mr. Chairman and Members of the Committee:

My name is Harry Pryde and I am a homebuilder and developer from Seattle, Washington. I am submitting this statement on behalf of the more than 110,000 members of the National Association of Home Builders (NAHB). NAHB is a trade association of the nation's homebuilding industry of which I am President. I appreciate the opportunity to present NAHB's views on enterprise zones.

Housing production is a key ingredient to assure a workable enterprise zone concept. I would like to first discuss the status of rental housing in our nation because it is fundamental to our support for sufficient tax and regulatory incentives for the construction or rehabilitation of housing in enterprise zones.

RENTAL HOUSING

Mr. Chairman, even without the disastrous effects of high interest rates in 1981 and 1982 on the housing industry, the level of activity in multifamily rental construction would still be extremely low. This situation has its most significant impact on urban areas with high population densities. Multifamily housing starts declined from 456,000 in 1978 to 259,000 in 1982, yet the demand for rental housing is still strong. Equally troubling is the low level of privately financed multifamily rental construction. In 1982, of about 239,000 multifamily rental units built, only 185,000 were privately financed.

Mr. Chairman, because of the decaying conditions of many urban areas, the existence of rent control and restrictions on condominium conversions, multifamily rental construction does not represent a viable investment in many areas of he country. The affordable rental housing situation in the United States is of crisis proportion. Affordable rental units are unavailable in major urban areas.

Although the Economic Recovery Tax Act of 1981 improved the climate for real estate investment, the comparative benefits for residential construction vis-a-vis other investments do not sufficiently encourage rental housing production and rehabilitation. In fact, a 1981 study by the Library of Congress indicates that the effective tax rate on apartment buildings is higher than for almost any other type of asset. Furthermore, a 1982 analysis by the Department of Treasury reveals that real estate structures continue to have less overall tax deductions than other assets beause they are not permitted the investment tax credit. There are tax incentives, which will be discussed later in my statement, that can assist residential multifamily construction.

In addition to relatively high interest rates and the lack of adequate tax incentives, the planning, zoning and total regulatory climate at the local level also inhibits construction in most areas. NAHB has testified in the past about the cost and time delay caused by government overregulation. A 1981 study conducted by the Council on Development Choices for the 1980's, "The Affordable Community--Adapting Today's Communities to Tomorrow's Needs," concluded that significant changes in state and local regulations are necessary to ensure affordable housing. Zoning, density, land use and site design regulations must be relaxed by states and localities to encourage housing development. In fact, under a program administered by the Department of Housing and Urban Development, the Joint Venture for Affordable Housing, three projects completed under local regulatory waivers have cost savings of 11% to 23% in comparison to projects built under current local regulations within the same jurisdictions.

A commitment from all levels of government and the private sector, in both the areas of tax incentives and deregulation, is needed to improve the climate for investment in multifamily rental construction.

ENTERPRISE ZONES

NAHB believes the enterprise zone concept is a positive approach to promote economic revitalization and job creation through tax incentives and deregulation.

The enterprise zone legislation being debated by the Senate Finance Committee contains many of the critical philosophical elements necessary to make the enterprise zone concept work, although some of the tax and deregulation elements must be strengthened. But we believe that most of all, an essential ingredient to make enterprise zones successful is the inclusion of sufficient incentives for the production of housing.

The purpose of enterprise zones is to promote economic growth, through the expansion of industry, in our most depressed areas. The jobs that will be created, however, will increase the demand for affordable housing in these areas. Most of the available jobs will be lower paying, requiring reasonably priced rental housing and homeownership opportunities. I have already addressed some of the obstacles facing this type of construction.

In the past couple of years, this Administration and Congress have severely restricted government assistance for low and moderate income housing. In the absence of this assistance, it is imperative that enterprise zone legislation provide sufficient tax incentives, and promote deregulation, to encourage long-term financing commitments for housing construction.

Tax Incentives

To this extent, NAHB strongly endorses the investment tax credit for housing construction currently included in the legislation being discussed. The 10% nonrefundable investment tax credit for the construction or rehabilitation of commercial, industrial or rental housing structures within a zone, included in the Enterprise Zone Employment and Development Act of 1983, S.863, will help to provide an immediate incentive to construct housing in an enterprise zone. The investment tax credit provides a sound business reason to build in an area which would otherwise not attract this type of investment. S.863, therefore, is preferable to other proposals which limit the credit to low income housing.

NAHB also supports additional tax incentives included in the enterprise zone legislation being considered by the Committee that will promote real estate investment in areas of revitalization:

- An exclusion from capital gains for real property sold within an enterprise zone as provided in S.863 (Section 221). A special rule which would permit deferral of capital gains for investment and reinvestment in low income housing within a zone would also be helpful (S.634, Section 221).
- A 30 percent tax credit for the rehabilitation of 40-year old structures and a 25 percent credit for the rehabilitation of 30-year old structures used for low-income housing provided at least $10,000 per unit is spent on the rehabilitation (S.634, Section 222).
- An increase in the residential energy tax credit from 15 percent to 40 percent, for installing energy conservation or renewable energy equipment in area residences as well as an extension of the credit for units in zones beyond its current expiration date of December 31, 1985 (S.634, Section 501).
- The continued availablity of small issue Industrial Development Bonds (IDBs) in enterprise zones, and the restoration of accelerated cost recovery for IDB financed property (S.863, Section 231).

Furthermore, the Committee may want to consider some additional tax incentives for multifamily construction. Perhaps such incentives could be incorporated into enterprise zone proposals to make real estate an attractive investment compared to other less risky alternatives such as stocks and bonds:

- Shortening of the straight line depreciation period for housing construction and substantial rehabilitation from 15 years to 8 years.

- Adjustment of the maximum per unit deductibility level for depreciation on the rehabilitation of low income housing under Section 167(k)(2)(A) of the Internal Revenue Code from $20,000 per unit to $40,000 per unit.
- Classify housing construction for low and moderate income families as a business venture to avoid the "hobby loss" provision under Section 183 of the IRS Code to ensure the depreciation of this property.
- A special investment tax credit for operating cost to automatically kick-in after five years of occupancy of qualified low-income buildings. This provision is included in legislation introduced by Rep. Stewart McKinney, the Residential Rental Housing Tax Incentive Act of 1983, H.R.637.

Deregulation

Economic revitalization in enterprise zones will not be spurred by tax relief alone. Deregulation is equally important. States and localities must be encouraged, as under the proposed bills, to provide regulatory relief. Relaxation of the regulatory burden must be a critical factor in the award of an enterprise zone. Localities should be encouraged to waive local zoning and planning requirements and licensing procedures. Non-imposition of rent regulation or condominium conversion restrictions and other regulations deterimental to housing production should also be an important factor in enterprise zone designation.

With respect to employment incentives, Congress should consider waiving or at least relaxing the federal minimum wage requirements in enterprise zones. Although not included in the legislation being considered, this provision seems essential to encourage competitive business activity and prevent the wholesale export of jobs.

The Enterprise Zone Employment and Development Act of 1983 allows state and local governments to jointly apply for the modification of nonstatutory federal regulations if this is in the public interest and would not present a risk to health, safety or the environment. NAHB believes that this is an important step to provide for economic revitalization in enterprise zones.

Other Recommendations

New incentives to promote major rehabilitation and housing production in zones must also be coordinated with existing housing and community development programs. S.634 directs the Secretary of HUD to promote coordination of housing, community development, financial assistance and employment programs. The bill also requires that federal aid be directed to revitalization areas. S.863 encourages state and local governments to provide Community Development Block Grant (CDBG), Urban Development Action Grant (UDAG) and revenue sharing funds for projects which contribute to economic development within a zone. These provisions should not only be retained but can be strengthened by providing that an appropriate percentage of CDBG, housing voucher or any new rental housing production funds be targeted to enterprise zones.

In addition, NAHB believes that Congress should consider not limiting the number of enterprise zones that can be created. This decision should be left to the discretion of the Secretary of HUD. The program should begin as a demonstration, and if it proves successful, the number of zones should not be limited by law. If on the other hand, the concept proves unworkable, then we would not be committed to unnecessarily large numbers of zones.

Finally, in order to minimize political influence in the nomination of zones, S.634 permits the local government to nominate an area for revitalization designation if, within 60 days after it requests the state, the state fails to nominate the area. This provision is essential to minimize political influence in zone designation.

CONCLUSION

Mr. Chairman, NAHB supports the enterprise zone concept as a workable undertaking that can work by incorporating the suggestions we have made. Along with others interested in enterprise zones, we hope the Congress will lend its support to a workable approach that the private sector can endorse.

Clearly, the purpose of enterprise zones is to redevelop and revitalize depressed areas by generating new jobs and economic activity. A successful enterprise zone, including tax and regulatory incentives for housing production, will provide a boost to the growth of our depressed areas.

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